PREMIER EDUCATION GROUP, LP

REPORT ON VALUATION OF A

100% EQUITY INTEREST

AS OF MARCH 31, 2002 AND

DECEMBER 31, 2006

PREPARED BY

WEISER LLP
NEW YORK, NEW YORK

PREMIER EDUCATION GROUP, LP
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Weiser

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Mr. Michael S. Waters, Esq.
McElroy, Deutsch, Mulvany & Carpenter
Three Gateway Center
100 Mulberry Street
Newark, New Jersey

Subject: Fair Market Value of a 100% Equity Interest
At March 31, 2002 and December 31, 2006

Dear Mr. Waters:

The attached valuation report was prepared for the specific purpose of valuing a 100% equity interest in Premier Education Group, LLP as of the captioned dates. The valuation will be used in connection with a litigation in a bankruptcy proceeding.

It was prepared for this specific purpose and is not to be copied or made available to any persons without the express written consent of Weiser LLP. A valuation for a different purpose, under a different standard (*definition*) of value, or for a different date of value could result in a materially different opinion of value.

Valuation conclusions are the result of professional judgment, experience and opinion. This is acknowledged by valuation and appraisal organizations, the courts and government agencies. For example, *IRS Revenue Ruling 59-60* (at Section 3.01) states the following:

> *Often, an appraiser will find wide differences of opinion as to the fair market value of a particular stock. In resolving such differences, he should maintain a reasonable attitude in recognition of the fact that valuation is not an exact science. A sound valuation will be based on all relevant facts, but the elements of common sense, informed judgment and reasonableness must enter into the process of weighing those facts and deciding their aggregate significance.*

This valuation report provides our professional opinion of value. We have performed this valuation in a professional manner in accordance with recognized industry practices. We make no further warranty, express or implied.

Weiser LLP

Martin J. Lieberman

MARTIN J. LIEBERMAN, CPA/ABV, ASA
New York, New York
May 14, 2007

INTRODUCTION

DESCRIPTION OF THE ASSIGNMENT

Weiser LLP has been engaged by Michael S. Waters, Esq., Trustee to render the business appraisal services described below. The following information summarizes our assignment:

Client Name	Michael S. Waters, Esq.
Business Name	Premier Education Group, LP
Type of Entity	Limited Partnership
State of Organization	Pennsylvania
Principal Business Location	Philadelphia, PA and Ambler, PA
Business Interest Valued	100% Equity Interest
Standard of Value	Fair market value
Premise of Value	Going concern
Effective Dates of Appraisals	March 31, 2002 and December 31, 2006
Purpose and Intended Use of Appraisal	Litigation

LEVELS OF VALUE

Although valuation is a range concept, current valuation theory suggests that there are three basic "levels" of value applicable to a business or business interest. The levels of value are respectively:

Controlling Interest: the value of the enterprise as a whole.

As-if Freely Tradable Minority Interest: the value of a minority interest, lacking control, but enjoying the benefit of market liquidity.

Non-Marketable Minority Interest: the value of a minority interest lacking both control and market liquidity.

This valuation is prepared on a controlling interest basis.

STATEMENT OF SCOPE AND LIMITATIONS

This valuation report has been prepared in accordance with the *Uniform Standards of Appraisal Practice of the Appraisal Foundation.* Standards 9 and 10 apply directly to the preparation of valuation reports of business interests. In general, these requirements are binding. However, flexibility with regard to the extent of certain information contained within the written appraisal report (Standards Rule 10-2) is permitted. Therefore, this report's contents have been limited to discussion of those elements deemed critical to the formation of our opinion. In accordance with these standards, a Statement of Limiting Conditions is provided as Appendix A and a Statement of Appraiser Qualifications is included in Appendix B.

Preparation of this report involved the review of substantial documentation with respect to the Company, its industry and the national economy. Sources of information reviewed relative to the Company are summarized in Appendix C. Sources of information related to the industry and the national economy are cited specifically at appropriate sections of the report.

In all cases we have relied upon the referenced information without independent verification. This report is, therefore, dependent upon the information provided. A material change in critical information relied upon in this report would be cause for a reassessment to determine the effect if any, upon our conclusion.

STANDARD OF VALUE

Fair market value is defined by the American Society of Appraisers:

> *The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both parties have reasonable knowledge of the relevant facts.*

OVERVIEW OF COMPANY

BRIEF HISTORY AND BACKGROUND

Premier Education Group, L.P. (formerly CEC Partnership, L.P.) ("PEG" or the "Company") was established on February 1, 1993 as a limited partnership. In March 1993 the Partnership purchased the assets of the Branford Hall School of Business and took over the management and operation of the school. Branford Hall, originally founded and incorporated in 1965, was granted approval by the Connecticut Commissioner of Higher Education in 1969 and later accredited as a business school by the Accrediting Council for Independent Colleges and Schools in 1977. [1]

[1] Premier Education Group Audited Financial Statements audited by Dennis Halterman, CPA.

Two additional locations in the state of Connecticut were established in the fall of 1996 and 1997. The Company purchased the assets and took over the management and operations of additional schools as follows:

School	Location	Date of Acquisition
Institute of Western Massachusetts	Massachusetts	October 1999
Dover Technical School	Ronkonkoma, New York	February 2001
Suburban Technical School	Hempstead, New York	June 2001
Seacoast Career Works	Wells, Maine	August 2001
Salter Schools Inc	Worcester and Springfield, Massachusetts	January, 2002

The Company operates 20 campuses in Maine, New Hampshire, Massachusetts, Connecticut and New York.[2] The aggregate school population today is approximately fifty-six hundred students.

The following is a listing of the schools, locations, and programs offered:[3]

Branford Hall Career Institute	Medical Assistant	Medical Billing	HVAC	Massage Therapy	Computer Information Technology	Paralegal	Culinary Arts
Albany, NY	X	X					
Bohemia, NY	X	X	X				
Branford, Conn	X	X		X		X	
Southington, Conn	X	X		X	X	X	
Springfield, Mass	X	X	X	X			X
Windsor, Conn	X	X		X	X	X	

[2] From Gary Camp deposition on 4/30/2007.
[3] http://www.premiereducationgroup.com/

The Salter School	Medical Assistant	Medical Billing	Accounting	Massage Therapy	Legal Office Administration	Paralegal	Culinary Arts
Cambridge, Mass	X	X				X	
Tewksbury, Mass	X	X		X		X	
Fall River, Mass	X	X		X			
Worcester, Mass***		X	X	X	X		X
Malden, Mass	X	X		X			

***Additional degrees in Worcester include Office Support Specialist, Medical Office Administration, and Executive Office Administration.

Seacoast Career Schools	Medical Assistant	Medical Billing	Massage Therapy
Manchester, NH	X	X	X
Sanford, ME	X	X	X

Suburban Technical School	Medical Assistant
Hempstead, NY	X

Harris School of Business	Medical Assistant	Massage Therapy	Health Information Technology	Computer Accounting Technology	Legal Office Technology	Microsoft Office Professional Applications
Cherry Hill, NJ	X	X	X	X	X	X
Linwood, NJ***	X	X		X	X	
Trenton, NJ	X	X	X	X	X	X
Wilmington, DE***	X	X				

***Linwood also offers a degree for Pharmacy Technicians, and Wilmington offers a degree for Medical Billings.

Classes are formed on a "modular" system referring to commencement of new classes every five to ten weeks throughout the year based on enrollment. Programs generally are from nine to twelve months in duration.[4]

Financial Aid[5]

Financial aid is available, for those who qualify, from a variety of sources. Applicants are given information and assistance in filling out all necessary forms for receiving grant and loan awards. A private meeting is scheduled with the Financial Aid Department after the submission of the Application for Admissions.

Students receive financial support from various aid programs. Some of these funds originate from federal financial aid programs as well as in house financing plans.

Financial aid sources include the following:

1. Federal Pell Grants
2. Federal Education Opportunity Grants
3. SALLIE MAE student financing programs
4. Federal Stafford loans

Accreditations[6]

<u>Bradford Hall Career Institute</u>

- Approved by the Connecticut Commissioner of Higher Education
- Approved training participant State of Connecticut, Workers' Compensation
- Approved training participant State of Connecticut Division of Rehabilitation Services
- Approved by the Department of Higher Education for Veterans' Benefits
- Member of Association of Connecticut Career Schools
- Member of Connecticut Association of Professional Financial Aid Administrators
- Member of National Association of Student Financial Aid Administrators
- Member of National Business Education Association
- Member of Branford, CT Chamber of Commerce
- Member of Southington, CT Chamber of Commerce
- Member of National Federation of Paralegal Associations
- Member of Better Business Bureau of Southeast Connecticut, Inc.
- Member of The National Phlebotomy Association, Inc.
- Member of National Center for Competency Testing
- Member of Long Island Business Association
- Member of Massachusetts Association of Private Career Schools
- Licensed by New York State Education Department, Bureau of Proprietary School Supervision

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[4] From Gary Camp deposition on 4/30/2007.
[5] http://www.premiereducationgroup.com
[6] *ibid*

- CAAHEP (AAMA) Programmatic Accreditation for our Branford Campus Medical Assistant Program
- ABHES Programmatic Accreditation for our Southington, Springfield, and Windsor Campuses Medical Assistant Program.

<u>The Salter School</u>
- Accredited by the Accrediting Council for Independent Colleges and Schools

<u>Seacoast Career Schools</u>
Accrediting Council for Continuing Education and Training (ACCET)

- State of Maine Department of Education
- State of New Hampshire Postsecondary Education Commission
- Maine State Approving Agency for Veterans Education
- New Hampshire State Agency for Veterans Education

<u>Suburban Technical School</u>
Accredited by the Accrediting Commission of Career Schools and Colleges of Technology.

<u>Harris School of Business</u>

Cherry Hill, Linwood and Trenton campuses are accredited by:
- Accrediting Council for Independent Colleges and Schools.

Wilmington campus is accredited by:
- Accrediting Council for Continuing Education & Training.

<u>MANAGEMENT</u>

The partnership agreement of CEC Partnership, L.P. (predecessor to Premier Education Group, L.P.) designates its general partner, CEC G.P., Inc. (the "General Partner" prior to May 1, 2003) as manager at a fee of $90,000 per annum. The paragraph in the CEC Partnership, L.P. agreement describing management authority follows.

The Partnership shall be managed by the General Partner and the conduct of the Partnership's business shall be controlled and conducted solely by the General Partner in accordance with this Agreement. Except as otherwise specifically provided in this Agreement, the General Partner shall have full, complete, and exclusive discretion to take any and all action of whatever type that the Partnership is authorized to take and make all decisions with respect thereto and to have and exercise on behalf of the Partnership all powers and rights necessary, proper, convenient, or advisable t o effectuate and carry out the purposes and business of the Partnership.

The partnership agreement of Premier Education Group, L.P. (successor to CEC Partnership, L.P.) designates its general partner, Premier Education Group G.P., Inc. (the "General Partner" commencing May 1, 2003) as manager at no specified fee. The paragraph in the Premier Education Group, L.P. agreement describing management authority follows:

Authority of the General Partner. Except to the extent otherwise provided in this Agreement, including Section 7.3, the General Partner shall have the sole and exclusive right to manage the business of the Partnership and shall have all of the rights and powers which may be possessed by general partners under the Act...

FINANCIAL ANALYSIS

NON-PUBLIC PEER GROUP FOR FINANCIAL PERFORMANCE COMPARISON

For purposes of comparison with industry financial measures available from non-public company sources, we reviewed the Annual Statement Studies 2001-2002 and 2005-2006, published by Robert Morris Associates ("RMA"). RMA compiled average percentage income statements and balance sheets and key financial ratios of entities with the Standard Industrial Classification ("SIC") of 8221. Colleges, Universities and Professional Schools with sales from 25 million dollars and over were chosen for comparison. The RMA reports include data for the fiscal years ended October 1, 2000 to March 31, 2001 and October 1, 2004 to March 31, 2005. The selected RMA group includes 267 companies for 2001-2002 and 279 companies for 2005-2006. We believe the RMA data provides limited comparative perspective and strict comparisons should be made with caution.

We were provided with annual audited historic balance sheets as of December 31, 2001 through 2005 and income statements for the years then ended reproduced in Appendix D: Schedules 1 and 3, respectively. We relied on these financial statements in performing our financial analysis.

The accountant's audit opinion is unqualified and attests that the financial statements are prepared in accordance with generally accepted accounting principles ("GAAP").

BOOK VALUE AND GENERAL FINANCIAL CONDITION AS OF DECEMBER 31, 2001

Financial Position and Leverage

Historical balance sheets are shown in Appendix D: Schedule 1.

Historical percentage balance sheets are shown in Appendix D: Schedule 2.

As of December 31, 2001, reported total assets are $9,834,654, total liabilities are $7,097,860 and shareholders' equity is $2,736,864.

As of December 31, 2001, assets consist of cash and cash equivalents of $879,607, tuition receivable of $6,100,227, demand loans receivable of $683,000, Inventory-books and supplies of $115,250, other current assets of 392,100, fixed assets net of depreciation of $1,376,296, and other assets of $288,174. Current liabilities consist of bank loans payable short term of $347,016, promissory notes-short term of $300,000, leases payable short-term $26,166, accounts payable and accrued expenses $559,009, accrued payroll and taxes of $222,861 and unearned tuition of $2,150,520. Long-term liabilities totaled $3,492,218.

EARNINGS PERFORMANCE AND CAPABILITY FOR THE YEAR ENDED DECEMBER 31, 2001

Reported Revenues and Margins

Historical income statements are shown in Appendix D: Schedule 3.

Historical percentage income statements are shown in Appendix D: Schedule 4.

Historical multi-year income statements averages are shown in Appendix D: Schedule 6.

For the year ended as of December 31, 2001, total revenues are $13,288,217.

Education, selling, administrative and occupancy expenses for the year ended December 31, 2001 are $11,969,654.

Reported Margin Analysis

For the year ended December 31, 2001

	RMA	2001
Revenue	100.0%	100.0%
Operating expenses	94.2%	90.08%
Operating profit (loss)	5.8%	9.92%
Other income (expense)	(3.2%)	-1.96
Reported pre-tax income	2.6%	7.96%

KEY FINANCIAL RATIO ANALYSIS AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2001

Historical percentage balance sheets and income statements of the Company are shown in Appendix D: Schedules 2 and 4. Key financial ratios are shown in Appendix D: Schedule 5.

As compared to RMA data, the Company's financial position is mixed. The liquidity ratios as compared to RMA are favorable given the current ratio of 2.27 and quick ratio of 2.23 for the Company as compared to 2.2 and 1.5 respectively for the RMA benchmark. The debt to net worth ratio is unfavorable when compared to the RMA data. The Company's operating profits and pre-tax income as a percentage of sales is substantially higher than the RMA benchmarks and return on equity in 2001 is also higher than the RMA data.

BOOK VALUE AND GENERAL FINANCIAL CONDITION AS OF DECEMBER 31, 2005

We were not given financial statements of the Company for the year ended December 31, 2006. Consequently, we used the last available data presented to us, financial statements for the year ended December 31, 2005. Had our analysis incorporated information from the Company's financial statements for the year ended December 31, 2006, our conclusions might be different from those presented.

Financial Position and Leverage

Historical balance sheets are shown in Appendix D: Schedule 1.

Historical percentage balance sheets are shown in Appendix D: Schedule 2.

As of December 31, 2005, reported total assets are $41,660,222, total liabilities are $36,070,300 and shareholders' equity is $5,589,922.

As of December 31, 2005, assets consist of cash and cash equivalents of $7,557,447, tuition receivable of $27,586,907, demand loans receivable of $2,652,567, Inventory-books and supplies of $141,867, other current assets of $1,488,862, fixed assets net of depreciation of $1,868,333, and other assets of $364,239. Current liabilities consist of bank loans payable-short term of $6,567, promissory notes-short term of $353,604, leases payable short-term $52,723, accounts payable and accrued expenses $2,287,071, accrued payroll and taxes of $805,532 and unearned tuition of $32,533,058. Long-term liabilities totaled $31,745.

EARNINGS PERFORMANCE AND CAPABILITY FOR THE YEAR ENDED DECEMBER 31, 2005

Reported Revenues and Margins

Historical income statements are shown in Appendix D: Schedule 3.

Historical percentage income statements are shown in Appendix D: Schedule 4.

Historical multi-year income statement averages are shown in Appendix D: Schedule 6.

For the year ended December 31, 2005, total revenues are $47,285,201, compared to total revenues in 2004 of $44,317,537, represents an increase of 6.7%.

Education, selling, administrative and occupancy expenses for the year ended December 31, 2005 are $38,673,611 compared to total expenses in 2004 of $33,850,900, an increase of 14.25%. All expenses increased as a percentage of net sales with the exception of advertising expense.

Reported Margin Analysis

For the years ended December 31, 2005 and 2004

	RMA	2005	2004
Revenue	100.0%	100.0%	100.0%
Operating expenses	91.7%	81.8%	76.4%
Operating profit (loss)	8.3%	18.2%	23.6%
Other income (expense)	-2.3%	-1.33%	-1.36
Reported pre-tax income	10.6%	16.9%	22.3%

KEY FINANCIAL RATIO ANALYSIS AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2005

Historical percentage balance sheets and income statements of the Company are shown in Appendix D: Schedules 1 and 3. Key financial ratios are shown in Appendix D: Schedule 5.

As compared to RMA data, the Company's financial position is mixed. The liquidity ratios as compared to RMA are unfavorable, being 1.09 and 1.09 for current and quick as compared to RMA's 2.1 and 1.7, respectively. The debt to net worth ratio is unfavorable when compared to the RMA data, it fluctuated during the last three years from 7.1 in 2003 to 0.6 in 2004 and then up again to 1.1 in 2005. The Company's operating profit and pre-tax income as a percentage of sales is substantially higher than RMA benchmarks and return on equity in 2005 is higher than the RMA data.

We note that the audited balance sheet as of December 31, 2004 as initially presented differs from the balance sheet presented as a comparison in the financial statements for the year ended December 31, 2005. An unexplained and unaccounted for difference in retained earnings and unearned tuition income payable exists between the two statements purporting to represent the financial position at the same date. We used the balance sheet presented with the 2005 financial statements in our analysis.

ECONOMIC AND INDUSTRY OUTLOOK

The financial success of a business entity is dependent upon conditions within the economy and the industry in which it operates. A prospective investor will temper the use of historical financial statistics on the basis of anticipated general economic conditions. An analysis of these factors has been incorporated into this valuation report.

The analysis of the national economy and the technical school industry for the first quarter of 2002 and the fourth quarter of 2006 are based upon a review of current economic statistics, articles in the financial press and economic reviews from current business periodicals. The purpose of the review is to provide a representative "consensus" on the condition of the national economy, the industry and its general outlook through 2002 and 2006. Reviews of the national economy are presented in Appendix E & F. The industry outlook is presented in the next section of this report.

INDUSTRY OUTLOOK

Postsecondary institutions—universities, colleges, professional schools, community or junior colleges, and career and technical institutes—provide education and training in both academic and technical subjects for high school graduates and other adults. Universities offer bachelor's, master's, and doctoral degrees, while colleges generally offer only the bachelor's degree. Professional schools offer graduate degrees in fields such as law, medicine, business administration, and engineering. The undergraduate bachelor's degree typically requires 4 years of study, while graduate degrees require additional years of study. Community and junior colleges and technical institutes offer associate degrees, certificates, or other diplomas, typically involving 2 years of study or less. Career and technical schools provide specialized training and services primarily related to a specific job. They include computer and cosmetology training

institutions, business and secretarial schools, correspondence schools, and establishments that offer certificates in commercial art and practical nursing.

This industry also includes institutions that provide training and services to schools and students, such as curriculum development, student exchanges, and tutoring. Also included are schools or programs that offer nonacademic or self-enrichment classes, such as automobile driving and cooking instruction, among other things.

In recent decades, the Nation has focused attention on the educational system because of the growing importance of producing a trained and educated workforce. Many institutions, including government, private industry, and research organizations, are involved in improving the quality of education.

Quality improvements also are being made to career and technical education at secondary and postsecondary schools. Academics are playing a more important role in career and technical curricula, and programs are being made more relevant to the local job market. Often, students must meet rigorous standards, set in consultation with private industry, before receiving a certificate or degree. Career and technical students in secondary school programs must pass the same standardized tests in core subject areas as students who are enrolled in academic programs of study. A growing number of career and technical programs are emphasizing general workplace skills, such as problem solving, teamwork, and customer service. Many high schools now offer technical preparatory ("tech-prep") programs, which are developed jointly by high schools and community colleges to provide a continuous course of study leading to an associate's degree or other postsecondary credential.

Computer technology continues to affect the education industry. Computers simplify administrative tasks and make it easier to track student performance. Teachers use the Internet in classrooms as well as to communicate with colleagues around the country; students use the Internet for research projects. Distance learning continues to expand as more postsecondary institutions use Internet-based technology to conduct lessons and coursework electronically, allowing students in distant locations access to educational opportunities formerly available only on campus.

Most educational institutions operate 10 months a year, but summer sessions for special education or remedial students are not uncommon; institutions that cater to adult students, and those that offer educational support services, such as tutoring, generally operate year-round as well. Education administrators, office and administrative support workers, and janitors and cleaners often work the entire year. Night and weekend work is common for teachers of adult literacy and remedial and self-enrichment education, for postsecondary teachers, and for library workers in postsecondary institutions. Part-time work is common for this same group of teachers, as well as for teacher assistants and school bus drivers. The latter often work a split shift, driving one or two routes in the morning and afternoon; drivers who are assigned to drive students on field trips, to athletic and other extracurricular activities, or to midday kindergarten programs work additional hours during or after school. Many teachers spend significant time outside of school preparing for class, doing administrative tasks, conducting research, writing articles and books, and pursuing advanced degrees.

Outlook

Wage and salary employment growth of 17 percent is expected in the educational services industry over the 2004–14 period, higher than the 14 percent increase projected for all industries combined. In addition, a greater-than-average number of workers are over the age of 45 in nearly all the major occupations that make up the industry—from janitors to education administrators—so it is likely that retirements will create large numbers of job openings in addition to those due to employment growth.

At the postsecondary level, increases in student enrollments and projected retirements of current faculty should contribute to a favorable job market for postsecondary teachers. As children of the baby boom generation continue to reach college age, and as more adults pursue continuing education to enhance or update their skills, postsecondary student enrollments are expected to increase rapidly, spurring much faster-than-average employment growth for postsecondary teachers.

EFFECT ON VALUATION

In 2002 the economy was on the downside creating risks to the assumed anticipated growth of PEG. In 2007 it was anticipated that the economy would grow but at a slower pace than had been experienced in 2005 and 2006. This circumstance serves to support the Company's growth prospects.

With the cost of a four-year education becoming increasing difficult for the "average" American family to afford, and decreased funding on a state and federal level, community colleges and vocational schools have become increasingly popular. Based on both, the U.S. economic forecasts and the industry outlook, there is no reason to suggest that the results achieved by PEG will not continue into the future.

DETERMINATION OF FAIR MARKET VALUE

OVERVIEW OF VALUATION APPROACHES

Three basic approaches to valuation are defined in the *Business Valuation Standards* of the American Society of Appraisers:

Asset Based Approach: A general way of determining a value indication of a business's assets and/or equity using one or more methods based directly on the value of the assets of the business less liabilities.

Income Approach: A general way of determining a value indication of a business's assets and/or equity using one or more methods wherein a value is determined by converting anticipated benefits.

Market Approach: A general way of determining a value indication of a business's assets and/or equity using one or more methods that compare the subject to similar investments that have been recently sold.

The various methods of valuation that appraisers use in practice are typically considered as subdivisions of the above three approaches. Valuation methods under the Market and Income Approaches generally contain common characteristics such as measures of earning power, discount rates and/or capitalization rates and multiples.

VALUATION METHODOLOGIES CONSIDERED BUT REJECTED

In our valuation analysis of one common share of the Company, the following valuation methodologies were considered but rejected as inappropriate for the valuation assignment:

<u>Asset Approach</u>–Since the Company is a service organization, which generally is paid fee's for services rendered, we have rejected the asset approach.

<u>Market Approach - Private Transactions</u> – No comparable transactions were identified. A guideline company approach using adjusted public company multiples is incorporated into this report as a reasonableness check (see page 21 of this report) and as an alternative valuation conclusion (see page 25 of this report).

VALUATION METHOD SELECTED - MARCH 31, 2002 VALUATION DATE

The capitalized income method is used when a company's current operations are indicative of its future operations (assuming a normal growth rate). On the other hand, the discounted cash flow method is used when future returns are expected to be "substantially different" from current operations. After consideration of the facts concerning the Company, we selected the discounted cash flow method ("DCF") in the valuation of PEG.

Cash flows under the DCF method are projected into the future until a point in which a stabilized level of operations is obtained. Beyond the projection period, the cash flows are projected to grow at an expected long-term sustainable growth rate into perpetuity. The value is determined by summing the cumulative present value of the discrete cash flows in the projection period and adding to that sum the present value of all cash flows beyond the projection period. The latter is called the "terminal value." The application of the DCF method is summarized in the following steps:

1. Decide on the reasonable period of time for which discrete projections can be made.

2. Estimate specific amounts of expected net cash flow for each of the discrete projection periods.

3. Estimate a long-term sustainable rate of growth in net cash flows from the end of the discrete projection period forward.

4. Estimate value as of the end of the discrete projection period by capitalizing the net cash flow in the period following the last year of the discrete projection period.

5. Discount each of the increments of cash flow back to present value at the discount rate (cost of capital) for the number of periods until it is received. Since it can be

expected that cash flows will be received throughout the year, the mid-year discounting convention is usually used.

6. Discount the "terminal value" (estimated in step 4) back to the present value for the number of periods in the discrete projection period (the same number of periods as the last increment of net cash flow).

7. Sum the values derived from steps 5 and 6.

PROJECTED CASH FLOW TO INVESTED CAPITAL

Net cash flow is the amount of cash that a business does not have to retain and invest in itself in order to sustain the projected levels of cash flows in future years. Based on our analysis of PEG, we have calculated cash flows to invested capital.

We had no access to the Company's management or any of its financial projections as of the Valuation Dates to develop an expected net cash flow. Accordingly, we used the Company's actual results of operations for the years 2002 to 2005 as the expected net cash flow model that is assumed to have existed in March 2002. This approach is justified based on PEG's report on 1st Quarter Results, 2004 (PEG 004115) in which the Company's management outlines a growth expectation that was realized in 2004 and 2005. We then estimated 2006 results based on 2005 results increased by a growth rate of 5%. A 5% growth rate is conservative as compared to the Company's Strategic Plan (PEG 003870) (the "Strategic Plan") showing a growth plan for years 2006 to 2010 in excess of 25% per annum. Countering the Strategic Plan is the actual growth rate from 2004 to 2005 of 6.6%. The actual growth rates for years 2002, 2003 and 2004 are 84.9%, 45.4% and 24%, respectively.

Had our analysis incorporated information from the Company's financial statements for the year ended December 31, 2006, our conclusions might be different from those presented.

The long-term growth rate for the Company post 2006 is stated at 5%, again a conservative estimate as compared to the Strategic Plan. Although, a history of more than tripling revenues in years 2001 to 2005 and testimony of Gary Camp, CEO, in a deposition taken on April 30, 2007, indicating that the Company was "on target" in achieving Strategic Plan goals based on first quarter 2007 results, validates the potential for the Strategic Plan to be realized. We started with a pared down valuation model. An alternative valuation model is presented later in this report using the Strategic Plan specified revenue (see page 25).

The net cash flow model we used does not take into account cash flows that were produced from a new business segment commenced in 2006 by an entity owned by certain of the same partners as own PEG disclosed by Gary Camp, CEO in a deposition taken on April 30, 2007. Were such cash flows included in our model our valuation results might be altered.

Presented in Exhibit D, Schedule 7, are PEG's income statements for the years ending December 31, 2002 through 2005, and the projected income statement for 2006. Adjustments were made to the financial statements to add back expenses for management fees paid to the General Partner of $90,000 in 2002 and $30,000 in 2003 as, based on the testimony of Gary Camp, no management

services were provided with respect to school operations.[7] Also added back, based on the allegation of the amended complaint of Premier et. al. v. Andrew Yao, were unauthorized amounts allegedly removed by the General Partner or related persons or entities totaling $1,217,623 in 2002 and $575,085 in 2003. It should be noted that 75% of unauthorized amount appears on Schedule 7, since the valuation date is March 31, 2002. Net profit was tax effected using a tax rate of approximately 22% recognizing the tax preference partners receive from pass through entities.

WEIGHTED AVERAGE COST OF CAPITAL

The discount rate or cost of capital used to convert the expected income to present value represents the expected rate of return required by the market to attract funds to a particular investment. It relates to the principle of substitution in that an investor will not invest in an asset if there is a more attractive substitute.

The cost of capital is determined by calculating the weighted average cost of debt and cost of equity. The cost of debt is the weighted average cost of debt paid by the Company. We have calculated the weighted average cost of debt as follows:

	Debt	% of Total Debt	Rate	Weighted
$400K Term Loan	98,912	4.1%	6.50%	0.26%
$80K Term Loan	30,838	1.3%	7.00%	0.09%
Various Term Loans	11,000	0.5%	8.50%	0.04%
Promissory N otes	2 ,300,000	94.2%	12.00%	11.31%
	2,440,750	100.0%		11.7%

It should be noted that the cost of debt was based on the year ended December 31, 2001, and was taken from the audited financial statements.

We have calculated the equity discount rate using the build up method. The build up method is based on the premise that the cost of equity is comprised of a number of identifiable risk factors that, when added together, result in the total return a prudent investor would demand for a particular investment. The model for the build up approach is as follows:

	Risk-free rate (Yield on 20-year T-bonds)
plus:	Equity risk premium
Plus	Small stock risk premium
plus:	Industry risk premium
equals:	Average small company return at appraisal date
plus:	Specific risk premium
equals:	Equity discount rate

[7] From Gary Camp deposition on 4/30/2007

Risk-free Rate

The risk-free rate is the rate of return available on investments that are essentially free of risk. The most appropriate proxy for the risk-free rate is the yield of a 20-year Treasury bond.

Equity Risk Premium

The expected amounts of return on equity securities is much less certain (or more risky) than the interest and maturity payments on U.S. Treasury obligations. To accept this greater risk, investors demand higher expected returns for investments in equities than investing in U.S. Treasury obligations. This differential in the expected return is called the equity risk premium.

The equity risk premium, as provided in Ibbotson Associates' Stocks Bonds Bills and Inflation Valuation Edition 2002 Yearbook, was used in preparing the PEG's discount rate. Specifically the long-horizon premium, as measured by using New York Stock Exchange benchmark ("NYSE") companies was selected as applicable to PEG. The equity risk premium is calculated by subtracting the arithmetic mean of the government bond return from the arithmetic mean of the stock market total return.

Small Stock Risk Premium

A small stock or size premium may be added to the build up method to account for the additional risk inherent in small company stocks. The premium is calculated by subtracting the small company arithmetic mean return from the large company arithmetic mean return. Based on the size of PEG, the 10^{th} decile size premium for NYSE stocks was used for the small company return.

Industry Risk Premium

Based on *Stocks, Bonds, Bills, and Inflation, 2003 Yearbook*, a publication of Ibbotson & Associates, this risk index compares the risk level of the industry with the market as a whole and averaged (4.60%) through December 31, 2002 for companies that were surveyed which are included in the SIC code 8221.

Specific Risk Premium

The specific risk premium is determined by the unique risk factors to a company. The Company's strengths and weaknesses, to the extent we knew them as we did not have the ability to interview management, were taken into account in determining this premium. Due to the net effect of these factors, and the Company's small size, it was determined that the Company was more risky than the typical publicly traded stock considered in the small stock risk premium. This premium includes the risk of investing in PEG and the risk of PEG achieving future projections. We have selected 5% for the specific risk of PEG.

The result of the build up method for the cost of equity is as follows:

Risk free rate	6.04%
Equity risk premium	6.60%
Small stock risk premium	5.73%
Industry risk premium	-4.60%
Specific risk premium	5.00%
Cost of Equity	18.77%

The allocation of invested capital between debt and equity is based on the industry median amount per Ibbotson Cost of Capital 2006 Yearbook for SIC code 8221.

The weighted average cost of capital is calculated as follows:

		Cost of Debt or Equity	Weighted Average Cost of Capital
Debt	4%	7.02%	0.28%
Equity	96%	18.77%	18.02%
WACC			18.30%

Growth Rate

The long-term growth rate is based upon a pared down estimate of the rate shown in the Strategic Plan discussed previously, general economic trends, and industry conditions. The rate of 5% represents the Company's growth rate as a mature business. This rate is reflective of the Company's stabilized, long-term rate of growth.

CALCULATION OF THE FAIR MARKET VALUE OF INVESTED CAPITAL

We have discounted the projected net cash flows to invested capital using the weighted average cost of capital. We added the sum of the discounted projected cash flows for the years ended December 31, 2002 through 2006 and the terminal value of all cash streams beyond the projection period to determine the value of invested capital. As detailed in Exhibit D, Schedule 7, this results in the value of $33,482,053. After deducting debt as of December 31, 2001 (last available data as of March 31, 2002) of $3,162,018, the market value of equity is $30,320,035 as of March 31, 2002.

VALUATION METHOD SELECTED - DECEMBER 31, 2006 VALUATION DATE

After considering the various approaches and methods to valuation as discussed above, we have again chosen an Income Approach to value the Company for the Valuation Date December 31, 2006.

Within the income approach we utilized the Capitalized Return Method. This method is also cash flow driven. Again, a cash flow driven method is the most appropriate under the circumstances to value the Company.

APPLICATION OF THE CAPITALIZED RETURN METHOD

The Capitalized Return Method is most appropriate when a company's earnings/cash flow are estimated to be stable and thereby considered a reasonable proxy for future earnings/cash flow based on anticipated growth rates sustainable in the long term. We have prepared a projection of earnings for 2006 using assumptions taken from the 2005 results of operation increased by a growth of 5% as described in the March 31, 2002 valuation. Had our analysis incorporated information from the Company's financial statements for the year ended December 31, 2006, our conclusions might be different from those presented.

As was done for the March 31, 2002 valuation, we have used a long-term growth rate of 5% for post 2006 revenues that would result in stabilized operations. The development of the method requires the following decisions:

1) The selection of a type of financial return to be capitalized.
2) A decision as to whether to use that return applicable to equity or to invested capital.
3) The selection of a capitalization rate to be applied to the return selected.

These decisions are explained in the following subsections.

Estimating the Returns to be Capitalized

The financial return selected should be a reasonable proxy for the anticipated future return to the holder of the interest being valued. The selection includes three steps: (i) the type of return, (ii) the number of historical years to be used to select the return proxy, and (iii) if more than one year, whether a weighting favoring some years over others, is appropriate. In this case we selected net cash flows because it is the level of benefits that is the best proxy for the return available to the equity members. In addition we selected the 2006 net cash flows, which reflect the Company's assumed earnings potential and stabilized value going forward.

Development of the Capitalization Rate

The fundamental premise underlying the selection of a capitalization rate is that the rate of return required by an investor in the subject company is the sum of the rate required by investors in risk-free securities, and a theoretically derived risk premium. The risk premium is indicative of the incremental rate of return demanded by investors on investments similar in risk to the subject. Hence the following equations:

$$\textit{Discount Rate} = \textit{Risk Free Rate} + \textit{Risk Premium(s)}.$$

$$\textit{Capitalization Rate} = \textit{Discount Rate} - \textit{Long Term Growth Rate}.$$

The same components used to determine the discount rate are identified to build up the capitalization rate. Such components for the December 31, 2006 Valuation Date follows:

Capitalization Rate Build-Up

Risk free rate	4.90%
Equity Risk Premium (Ibbotson's)	6.30%
Industry Risk Premium (Ibbotson's)	-4.73%
Small Stock Risk Premium (Ibbotson's)	6.27%
Specific Risk Premium	5.00%
Net Cash Flow Discount Rate	17.74%
Minus: long-term Growth Rate	-5.00%
Net Cash Flow Capitalization Rate	12.74%

Summary and Indication of Value of the Operating Assets

The above capitalization rate is applied to the 2006 normalized net cash flows adjusted for midyear convention growth rate using the formula:[8]

$$PV = \frac{NCF * (1+k)^{0.5}}{k-g}$$

The following value was derived after using the formula as follows:

Normalized Net Cash Flows 2006 adjusted for midyear Convention ($NCF* (1 + k)^{0.5}$)	$	7,667,835
Capitalization Rate ($k - g$)		12.74
Invested Capital (PV)		60,187,090
Less interest bearing debt at December 31, 2005		(391,916)
Fair Market Value of a 100% equity interest	$	59,795,174

The capitalization of cash flow yields the present value of invested capital. From this amount debt is deducted to arrive at Fair Market Value of equity as shown above.

[8] James Hitchner. Financial Valuation, Applications and Models. Page 116. Wiley Finance, Hoboken, NJ.

CONSIDERATION OF DISCOUNTS AND PREMIUMS

When an interest lacks certain elements of control and marketability, two discounts are generally appropriate. They are commonly referred to as the discount for lack of control (a/k/a minority discount) and discount for lack of marketability.
The subject of this appraisal valuation report is a marketable, controlling interest. Accordingly, no discounts are provided.

A premium for control is not applicable as the cash flow stream and capital structure used to calculate value is applicable to a control interest. In other words, the valuation is conducted using control interest cash flows and the ability of an owner to borrow.

GUIDELINE COMPANY BENCHMARK

As a reasonableness test of our conclusions of value, we compared multiples of revenue and earnings to publicly traded guideline companies in the same industry as the Company.

A market approach using guideline companies requires estimates of: (1) a capitalization rate (or multiple) derived from publicly-traded or privately-held guideline companies and (2) ongoing earning power and/or asset base.

Guideline companies are companies that provide a reasonable basis for comparison to the relevant investment characteristics of a company being valued. Guideline companies are most often publicly-traded companies in the same or similar business as the valuation subject. Such companies provide what is commonly referred to as "public minority interest" valuation data. Guideline companies are used as a basis to develop valuation conclusions with respect to a subject company under the presumption that a similar market exists for the subject company as existed for the guideline companies.

An ideal guideline company would be one in the same business as the company being valued. However, if there is insufficient transaction evidence in the same business, it may be necessary to consider companies with an underlying similarity of relevant investment characteristics such as markets, products, growth, cyclical variability and other salient factors.

The guideline company method uses a group of public companies and/or privately-held companies selected for their ability to provide valuation guidelines for the analyst. The most commonly used version of the guideline company method develops a price/earnings ratio with which to capitalize net income. Other indicators include the capitalization of revenues, total assets, book value, or other indicators of value derived from the guideline company group.

SELECTED GUIDELINE COMPANIES

We accessed multiples of price for publicly traded stocks of technical schools. We compiled a list of companies and their associated multiples based on the following criteria:

1) The corporation's revenues are from operation of technical schools.

2) The corporation is listed in SIC Code 8221, Colleges, Universities and Professional Schools.

3) Adequate financial information (five years) about the corporation is publicly available.

4) The corporation was profitable in two of the last three years and three of the last five years.

5) The corporation is not currently involved in negotiations to be acquired or actually in the process of being acquired.

6) The corporation's stock is publicly traded and was listed in Standard & Poor's S&P Reports. Such a listing in indicative of investor interest.

We have reviewed a comprehensive list of public companies and determined that four companies met the above criteria. A brief description of each of these guideline companies (the"Guideline Companies") follows.

Description of The Guideline Companies

Career Education Corporation

Career Education Corporation, through its subsidiaries, provides educational services. It operates colleges, schools, and universities that offer education to approximately 90,000 students worldwide in various career-oriented disciplines. The company operates approximately 75 campuses that offer doctoral, master's, bachelor's, and associate degrees and diploma and certificate programs to students located in the United States, Canada, France, Italy, and the United Kingdom. Its career-oriented programs comprise culinary arts, including culinary arts, hotel and restaurant management, and baking and pastry arts; visual communication and design technologies comprising desktop publishing, graphic design, fashion design and merchandising, interior design, graphic imaging, Web page design, animation, photography, game design, digital film and media, and visual journalism; and health education, such as medical assistance, medical billing and coding, massage therapy, pharmacy technician, diagnostic medical ultrasound, cardiovascular technician, surgical technician, dental assistance, and medical office administration. The company also offers business studies programs, including business administration, business operations, merchandising management, business administration and marketing, paralegal studies, hospitality management, criminal justice, and education; and information technology programs, such as PC/LAN, PC/Net, computer technical support, computer network operation, computer information management, computer science and computer engineering, and computer programming. In addition, the company focuses on the development of a range of short-term online learning and informational programs that sell digital content and advertising space. Career Education Corporation was founded in 1994 and is headquartered in Hoffman Estates, Illinois

Corinthian Colleges

Corinthian Colleges, Inc. operates as a post-secondary education company in North America. It primarily offers various diploma programs, as well as associates, bachelors, and masters degrees.

As of June 30, 2006, the company operated 45 diploma-granting schools with curricula primarily in the healthcare and business fields that provide students the training required for various entry-level positions; 14 degree-granting colleges that offer curricula principally in healthcare, business, criminal justice, and information technology and electronics; 33 colleges in Canada, which offer diploma programs in allied health, business, criminal justice, and information technology; and two online operations, FMU Online and Everest Online, which offer online learning alternatives to students pursuing education exclusively online. It also operated 36 campuses, which offer diploma and degree programs in the fields of aircraft, automotive, diesel, marine, and motorcycle technologies; information and electronic technologies; other technical trades, such as plumbing and electrical; and criminal justice, business, and healthcare, as of the above date. Corinthian Colleges was founded in 1995 and is based in Santa Ana, California.

DeVry Inc.

DeVry, Inc., through its wholly owned subsidiaries, engages in the ownership and operation of DeVry University, Ross University, Deaconess College of Nursing, and Becker Professional Review. DeVry University provides undergraduate degree programs in technology, business, and healthcare technology, as well as graduate degree programs in management offered through Keller Graduate School of Management. Ross University operates two schools that include Ross University School of Medicine and Ross University School of Veterinary Medicine located in the Caribbean countries of Dominica and St. Kitts/Nevis. It provides medical and veterinary medical education. Deaconess College of Nursing offers various degree and degree completion programs for nurses and aspiring nurses. Becker Professional Review prepares candidates for the Certified Public Accountant, Certified Management Accountant, and Chartered Financial Analyst professional certification examinations. DeVry was founded in 1931 and is headquartered in Oakbrook Terrace, Illinois.

ITT Educational Services, Inc.

ITT Educational Services, Inc. provides postsecondary degree programs in the United States. It offers diploma, associate, bachelor, and master degree programs in the fields of information technology, electronics technology, drafting and design, business, criminal justice, and health sciences. As of March 22, 2007, the company operated 90 ITT Technical Institutes in 33 states, which primarily offered career-focused degree programs of study to approximately 47,000 students. ITT Educational Services was founded in 1946 and is headquartered in Carmel, Indiana.

ANALYSIS AND COMPARISON OF PUBLICLY TRADED GUIDELINE COMPANIES

We did not include ITT Educational Services in our compilation of comparable multiples since its multiples were far greater than the other guideline companies and caused the average of the group to be distorted.

The following observations are derived from the data presented in Appendix D.

1) Size – PEG is considerably smaller in terms of total assets and revenues than the Guideline Companies.

2) Profit margins – PEG had slightly higher net income before taxes as a percentage of sales (16.88%) for 2005 (last year of actual results made available to us) than the Guideline Companies average (16.53%).

3) Revenue growth – PEG's revenue growth in 2005, 2004 and 2003 was 6.7%, 24.0% and 84.9%, respectively versus the Guideline Companies growth of 9.66%..

PEG is significantly smaller than the Guideline Companies but up until 2005 growing at a dramatically faster rate. Therefore, we are utilizing 85% of the average of the Guideline Companies' multiples to compare to PEG's multiples based on the Fair Market Value determination using the Income Approach even though PEG's historical rate of growth is higher. Size trumps growth.

VALUATION USING GUIDELINE COMPANY ANALYSIS

Several multiples for valuing closely held companies are available under the guideline company analysis approach. Multiples measure some variation of earnings power or underlying assets, or a combination of the two. After a review of several multiples, we have relied on the following two multiples for comparison to PEG's multiples of our Fair Market Value conclusion.

1) Revenue/price

2) Earnings before depreciation, interest, and taxes ("EBITDA")/price

The equity value derived from market pricing generally represents the Fair Market Value of minority or non-controlling interests, since market prices of the Guideline Companies show what investors paid for minority interests. The public prices do not reflect the premiums a purchaser would most likely be forced to pay to acquire 100% control of these companies. We have investigated controlling purchase transactions over the last few years and determined that a premium for control of 17.2% is deemed appropriate for a control interest in 2006, and have included this premium in the calculation of the equity value and total invested capital of the Guideline Companies. For this purpose, we used "Going Private Valuation of Transactions" premium shown in Mergerstat Review for 2006 transactions. This adjustment does not include a premium associated with synergistic acquisitions.

The value multiples utilized in these approaches relates the Guideline Companies' total invested capital and equity value at the Valuation Date to revenue and EBITDA. Total invested capital is calculated as equity value (determined by publicly traded stock price and adjusted for control) plus debt at book value.

The following table presents the Guideline Companies adjusted multiples using the methodology as described as compared to PEG's corresponding multiples for 2006.

		Market Value of Invested Cap/		
Company	**Ticker**	**Revenue**	**EBITDA**	
Career Education Group	CECO	1.874	9.514	
Corinthian College	COCO	1.520	17.339	
DeVry, Inc.	DV	3.222	8.119	
Average		**2.205**	**11.657**	
@ 85%		**1.874**	**9.909**	
PEG		**1.204**	**5.962**	

PEG's multiples based on our Fair Market Value conclusion is significantly below the adjusted Guideline Company multiples, indicating that our value conclusion for PEG is conservative and on the lower end of a possible range of value conclusions. Accordingly, a comparison of the Guideline Companies adjusted multiples to PEG's multiples shows that the Fair Market Value determinations using the Income Approach is conservative.

VALUATION USING STRATEGIC PLAN

As an alternative valuation procedure we estimated a value for PEG using the revenue multiple derived above for the Guideline Companies at 85% applied to the Company's revenue for year 2010 projected in the Strategic Plan. We calculated the present value of the product of the 2010 Strategic Plan stated revenue ($180,000,000) by the adjusted revenue multiple (1.874) of the Guideline Companies using the Company's weighted average cost of capital (18.3%). The resulting values are as follows:

	2010
Market Value of Equity ($180,000,000 X 1.874674859)	$337,441,475
Discount Rate @ 18.30%	.51058
Market Value of Equity @ December 31, 2006	**$172,289,856**
Market Value of Equity ($180,000,000 X 1.874)	$337,441,475
Discount Rate @ 18.30%	.51058
Market Value of Equity @ March 31, 2002	**$77,550,125**

Value as of December 31, 2002 $77,550,000

Value as of December 31, 2006 $172,290,000

Our alternative valuation conclusion based solely on the Strategic Plan revenue projection for 2010 is the estimated Fair Market Value of a 100% equity interest in PEG as of March 31, 2002 of $77,550,000 and as of December 31, 2006 of $172,290,000.

Conclusion of Value

Based upon our analysis as outlined herein, it is our opinion that the estimated Fair Market Value of a 100% equity interest in PEG as of March 31, 2002, is $30,320,000, and as of December 31, 2006 is $59,795,000.

Weiser

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CERTIFICATION OF APPRAISERS

I certify that, to the best of my knowledge and belief:

- The statements of fact contained in this report are true and correct.
- The reported analyses, opinions, and conclusions are limited only by the reported assumptions and limiting conditions, and are my personal, impartial, and unbiased professional analyses, opinions and conclusions.
- I have no present or prospective interest in the business that is the subject of this report, and I have no personal interest with respect to the parties involved.
- I have no bias with respect to the property that is the subject of this report or to the parties involved with this assignment.
- My engagement in this assignment was not contingent upon developing or reporting predetermined results.
- My compensation for completing this assignment is not contingent upon the development or reporting of predetermined value or direction in value that favors the cause of the client, the amount of the value opinion, the attainment of a stipulated result, or the occurrence of a subsequent event directly related to the intended use of this appraisal.
- My analyses, opinions, and conclusions were developed, and this report has been prepared, in conformity with the *Uniform Standards of Professional Appraisal Practice*.
- No one provided significant professional assistance to the person signing this report, except Robert Neumann, CPA, a senior manager in the firm of Weiser LLP and Federico A. Jost, a senior analyst in the firm of Weiser LLP.

Martin J. Lieberman

Martin J. Lieberman, CPA/ABV, ASA

New York, New York
May 7, 2007

APPENDIX A: STATEMENT OF LIMITING CONDITIONS

This report has considered all the information referenced in it, whether specifically mentioned in the report or not. The various estimates and conclusions presented apply to this report only, and may not be used out of the context presented herein.

Possession of the original or copies of this report do not carry with it the right of publication of all or part of it. It was prepared for the exclusive use of Michael Waters, Trustee, and may not be used without their written consent and the written consent of Weiser LLP, and in any event, only with proper attribution. No copies of this report will be furnished to persons other than Michael Waters without their specific permission or direction unless ordered by a court of competent jurisdiction.

This report is based on the data provided by representatives of Michael Waters, Trustee. We have relied upon the referenced information without independent verification and this report is dependent upon the information provided.

Confidentiality/Advertising: This report and supporting documentation are confidential. Neither all nor any part of the contents of this appraisal shall be copied or disclosed to any party or conveyed to the public orally or in writing through advertising, public relations, news, sales, or in any other manner without the prior written consent and approval of both Weiser LLP and the management of Premier Education Group, LP.

Litigation Support: Depositions, expert testimony, attendance in court, and all preparations/ support for same, arising from this appraisal shall not be required unless arrangements for such services have been previously made.

Management: The opinion of value expressed herein assumes the continuation of prudent management policies over whatever period of time is deemed reasonable and necessary to maintain the character and integrity of the appraised business entity as a going concern.

Information and Data: Information supplied by others that was considered in this valuation is from sources believed to be reliable, and no further responsibility is assumed for its accuracy. We reserve the right to make such adjustments to the valuation herein reported as may be required by consideration of additional or more reliable data that may become available subsequent to the issuance of this report.

Purpose: All opinions of market value are presented as Weiser LLP's considered opinion based on the facts and data obtained during the course of the appraisal investigation. We assume no responsibility for changes in market conditions which might require a change in appraised value. The value conclusion derived in this appraisal was for the specific purpose set forth in this appraisal and shall not be used for any other purpose.

Fee Contingency: The fee established for the formulation and reporting of these conclusions is not contingent upon the value or other opinions presented.

Interest: Neither the appraiser nor any partner or employee of Weiser LLP has any interest in the property appraised.

Unexpected Conditions: We assume that there are no hidden or unexpected conditions of the property that would adversely affect value.

Non Appraisal Expertise: No opinion is intended for matters which require legal or specialized expertise, investigation or knowledge, beyond that customarily employed by appraisers.

Appendix B: Qualifications of Appraiser

Resume of: MARTIN J. LIEBERMAN, CPA/ABV, ASA

Present Position: Partner

Firm: Weiser LLP

Experience: Over twenty-five years experience managing, planning and supervising forensic, valuation and audit engagements for regional, national and multinational companies in the following industries:

- Technical Schools
- Real Estate
- Publishing
- Finance and leasing
- Construction
- Manufacturers
- Wholesalers

Serve as expert witness and consultant to attorneys
Plan and participate in structuring of mergers and acquisitions

Professional Activities:

Certified Public Accountant—New York
Accredited Business Valuator
American Society of Appraisers—Accredited Senior Appraiser
Former President, current Membership Chairman, Member of Board of Directors of American Society of Appraisers—NYC Chapter
Former Chairman of New York State Society of CPA's *Annual Business Valuation Conference*
American Institute of Certified Public Accountants
New York State Society of Certified Public Accountants—Business Valuation Committee
Co-authorship and contributions to various publications
Editor of *CPA Journal*—Business Valuation articles
Frequent public speaker

Education:

Baruch College, M.B.A.
Brooklyn College, B.S.

American Institute of Certified Public Accountants
Certificate of Achievement in Business Valuations
American Society of AppraisersCertificates of Completion of BV203 and BV204

Expert Testimony: (Last four years)	Andre Assous v Ellen Zoldessy et al, Deposition 2007 Harry Eisenberg et al v. Bulova Watch Company ,Deposition 2007 Alan B. Goer et al v. Jasco Industries, Inc. et al, Arbitration July 2006
Articles Written: (Last four years)	"Business Valuation Basics", *CPA Journal*, January, 2003 "Business Valuation Committee Establishes a Technical Response" *The Trusted Professional*– April, 2004 "The Handbook of Business Valuation and Intellectual Property Analysis, Review", *CPA Journal,* February 2005

APPENDIX C: SOURCES OF INFORMATION

Audited Financial Statements of Premier Education Group, L.P. for the years 2001 to 2005.

Federal Reserve System – Statistical Releases.

Pratt, Shannon P. and others, – *Valuing a Business, 4th ed.* (New York, NY: McGraw-Hill, 2000).

Morningstar SBBI 2007 Valuation Edition (former Ibbotson Associates publication).

Ibbotson Associates *Stocks Bonds Bills and Inflation 2003 Valuation Edition.*

Ibbotson Associates *Stocks Bonds Bills and Inflation 2007 Valuation Edition*

RMA Annual Statement Studies 2001-2002 and 2005-2006 Financial Ratios Benchmark.

The Wall Street Journal Database on Companies.

SEC website and Edgar files.

Deposition of Gary Camp - 04/30/2007.

Premier Education Group, Strategic Plan by Gary Camp, CEO, January 2006.

Premier Education Group, First Quarter Results 2004 by Gary Camp, CEO.

Complaint of Premier Education Group, L.P. et al V. Andrew Yao.

Mergerstat Review - 2006

Sources in Endnotes.

Other information, reviews and analyses that we deemed appropriate.

APPENDIX D: SCHEDULE NO. 1 THROUGH NO. 7

Schedule No.

1. Historical Balance Sheets December 31, 2001 through 2005.
2. Common Size Balance Sheets December 31, 2001 through 2005.
3. Historical Income Statements 2001 through 2005.
4. Common Size Income Statements 2001 through 2005.
5. Key Financial Ratios.
6. Multi-Year Averages & Growth Rates.
7. Projected Income Statements, Discounted Cash Flow and Capitalization analysis.

Schedule 1

Premier Education Group, LP
Historical Balance Sheets December 31, 2001 through 2005

	2001	2002	2003	2004	2005
ASSETS					
Current assets:					
Cash and cash equivalents	$ 879,607	$ 710,411	$ 3,628,780	$ 9,165,162	$ 7,557,447
Tuition receivable	6,100,227	12,311,602	18,677,467	20,900,079	27,586,907
Demand loan receivable	683,000	2,002,567	2,652,567	2,652,567	2,652,567
Inventory-books and supplies	115,250	134,304	169,395	128,940	141,867
Other current assets	392,100	723,320	453,065	780,675	1,488,862
Receivables from affiliated companies				40,548	
Total current assets	**8,170,184**	**15,882,204**	**25,581,274**	**33,667,971**	**39,427,650**
Fixed Assets:					
Lease hold improvements	278,555	313,410	383,848	456,256	623,522
Property and equipment	2,011,216	2,600,514	3,156,602	3,304,370	3,622,437
Office furniture	159,014	193,973	275,301	301,479	342,984
Library	31,199	35,583	37,905	40,788	40,788
Less: Accumulated depreciation	(1,103,688)	(1,385,091)	(1,795,955)	(2,265,025)	(2,761,398)
Total Fixed Assets	**1,376,296**	**1,758,389**	**2,057,701**	**1,837,868**	**1,868,333**
Other assets:					
Organization costs	139,074	139,074	285,581	285,581	485,581
Curriculim costs	248,201	268,201	389,694	414,694	414,694
Less:Accumulated Amortization	(99,101)	(166,744)	(268,645)	(402,247)	(536,036)
Total Other Assets	**288,174**	**240,531**	**406,630**	**298,028**	**364,239**
Total Assets	**$ 9,834,654**	**$ 17,881,124**	**$ 28,045,605**	**$ 35,803,867**	**$ 41,660,222**
LIABILITIES AND MEMBERS' EQUITY					
Current liabilities:					
Bank loans payable short term	$ 347,016	$ 695,789	$ 57,143	$ 6,567	$ 6,567
Promissory notes-short term	300,000	350,000	350,000	539,438	353,604
Leases payable-short term	26,166	74,253	85,692	73,204	52,723
Accounts payable and accrued expenses	559,009	1,070,364	2,670,773	3,209,692	2,287,071
Accrued payroll and taxes	222,861	385,730	364,530	387,441	805,532
Unearned tuition	2,150,520	4,042,935	5,405,629	27,120,015	32,533,058
Total Current Liabilities	**3,605,572**	**6,619,071**	**8,933,767**	**31,336,357**	**36,038,555**
Long Term Liabilities					
Loans Payable-long term	470,734	44,166	26,275	13,988	13,988
Promissory notes-long term	2,000,000	1,696,000	1,696,000	-	-
Leases payable-long term	18,032	166,705	52,570	33,028	17,757
Payable to affiliated companies	1,003,452	1,015,396	101,585		
Total Long Term Liabilities	**3,492,218**	**2,922,267**	**1,876,430**	**47,016**	**31,745**
Total Liabilities	**7,097,790**	**9,541,338**	**10,810,197**	**31,383,373**	**36,070,300**
Partnership Equity					
Partners contribution	4,360,000	4,360,000	4,360,000	4,360,000	4,360,000
Retained earnings	(1,623,136)	3,979,786	12,875,408	60,494	1,229,922
Total Equity	**2,736,864**	**8,339,786**	**17,235,408**	**4,420,494**	**5,589,922**
Total liabilities and members' equity	**$ 9,834,654**	**$ 17,881,124**	**$ 28,045,605**	**$ 35,803,867**	**$ 41,660,222**

Schedule 2

Premier Education Group, LP
Common Size Balance Sheets December 31, 2001 through 2005

	2001	2002	2003	2004	2005
ASSETS					
Current assets:					
Cash and cash equivalents	8.94%	3.97%	12.94%	25.60%	18.14%
Tuition receivable	62.03%	68.85%	66.60%	58.37%	66.22%
Demand loan receivable	6.94%	11.20%	9.46%	7.41%	6.37%
Inventory-books and supplies	1.17%	0.75%	0.60%	0.36%	0.34%
Other current assets	3.99%	4.05%	1.62%	2.18%	3.57%
Receivables from affiliated companies				0.11%	
Total current assets	**83.08%**	**88.82%**	**91.21%**	**94.03%**	**94.64%**
Fixed Assets:					
Lease hold improvements	2.83%	1.75%	1.37%	1.27%	1.50%
Property and equipment	20.45%	14.54%	11.26%	9.23%	8.70%
Office furniture	1.62%	1.08%	0.98%	0.84%	0.82%
Library	0.32%	0.20%	0.14%	0.11%	0.10%
Less: Accumulated depreciation	-11.22%	-7.75%	-6.40%	-6.33%	-6.63%
Total Fixed Assets	**13.99%**	**9.83%**	**7.34%**	**5.13%**	**4.48%**
Other assets:					
Organization costs	1.41%	0.78%	1.02%	0.80%	1.17%
Curriculim costs	2.52%	1.50%	1.39%	1.16%	1.00%
Less:Accumulated Amortization	-1.01%	-0.93%	-0.96%	-1.12%	-1.29%
Total Other Assets	**2.93%**	**1.35%**	**1.45%**	**0.83%**	**0.87%**
Total Assets	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**
LIABILITIES AND MEMBERS' EQUITY					
Current liabilities:					
Bank loans payable short term	3.53%	3.89%	0.20%	0.02%	0.02%
Promissory notes-short term	3.05%	1.96%	1.25%	1.51%	0.85%
Leases payable-short term	0.27%	0.42%	0.31%	0.20%	0.13%
Accounts payable and accrued expenses	5.68%	5.99%	9.52%	8.96%	5.49%
Accrued payroll and taxes	2.27%	2.16%	1.30%	1.08%	1.93%
Unearned tuition	21.87%	22.61%	19.27%	75.75%	78.09%
Total Current Liabilities	**36.66%**	**37.02%**	**31.85%**	**87.52%**	**86.51%**
Long Term Liabilities					
Loans Payable-long term	4.79%	0.25%	0.09%	0.04%	0.03%
Promissory notes-long term	20.34%	9.48%	6.05%	0.00%	0.00%
Leases payable-long term	0.18%	0.93%	0.19%	0.09%	0.04%
Payable to affiliated companies	10.20%	5.68%	0.36%	0.00%	0.00%
Total Long Term Liabilities	**35.51%**	**16.34%**	**6.69%**	**0.13%**	**0.08%**
Total Liabilities	**72.17%**	**53.36%**	**38.55%**	**87.65%**	**86.58%**
Partnership Equity					
Partners contribution	44.33%	24.38%	15.55%	12.18%	10.47%
Retained earnings	-16.50%	22.26%	45.91%	0.17%	2.95%
Total Equity	**27.83%**	**46.64%**	**61.45%**	**12.35%**	**13.42%**
Total liabilities and members' equity	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**

Schedule 3

Premier Education Group, LP
Historical Income Statements 2001 through 2005

	2001	2002	2003	2004	2005
Revenues					
Earned tuition	$ 13,573,423	$ 26,103,912	$ 34,560,170	$ 42,554,445	$ 43,564,836
Tuition refunds	(695,363)	(2,352,153)			
Other revenues	410,157	817,605	1,171,779	1,763,092	3,720,365
Total Income	13,288,217	24,569,364	35,731,949	44,317,537	47,285,201
Education Expense					
Salaries	2,852,642	4,733,522	5,562,643	7,551,464	8,663,305
Educational suppl,ies	1,072,150	1,381,678	995,216	1,215,784	1,755,642
Selling Expense					
Salaries	878,291	1,218,799	1,175,642	1,773,053	1,977,167
Advertising	1,353,167	2,254,690	3,322,636	5,623,011	5,801,962
Administrative Expense					
Salaries	2,053,635	2,792,150	4,965,078	6,028,173	7,002,024
Office and general	2,485,686	3,812,711	6,692,537	7,136,909	7,975,378
Occupancy Expense					
Rent	914,452	1,743,118	2,395,628	3,251,384	3,780,066
Utilities	267,553	438,609	685,302	733,510	895,399
Maintenance and repairs	92,078	242,119	528,880	537,612	822,668
Total Operating Expenses	11,969,654	18,617,396	26,323,562	33,850,900	38,673,611
Profit from Operations	1,318,563	5,951,968	9,408,387	10,466,637	8,611,590
Other Expenses					
Depreciation	226,323	281,403	410,864	469,070	496,373
Amortization	34,973	67,643	101,901	133,602	133,789
NET PROFIT	$ 1,057,267	$ 5,602,922	$ 8,895,622	$ 9,863,965	$ 7,981,428

Schedule 4

Premier Education Group, LP
Common Size Income Statements 2001 through 2005

	2001	2002	2003	2004	2005
Income					
Earned tuition	102.15%	106.25%	96.72%	96.02%	92.13%
Tuition refunds	-5.23%	-9.57%	0.00%	0.00%	0.00%
Other revenues	3.09%	3.33%	3.28%	3.98%	7.87%
Total Income	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**
Education Expense					
Salaries	21.47%	19.27%	15.57%	17.04%	18.32%
Educational suppl,ies	8.07%	5.62%	2.79%	2.74%	3.71%
Selling Expense					
Salaries	6.61%	4.96%	3.29%	4.00%	4.18%
Advertising	10.18%	9.18%	9.30%	12.69%	12.27%
Administrative Expense					
Salaries	15.45%	11.36%	13.90%	13.60%	14.81%
Office and general	18.71%	15.52%	18.73%	16.10%	16.87%
Occupancy Expense					
Rent	6.88%	7.09%	6.70%	7.34%	7.99%
Utilities	2.01%	1.79%	1.92%	1.66%	1.89%
Maintenance and repairs	0.69%	0.99%	1.48%	1.21%	1.74%
Total Operating Expenses	90.08%	75.77%	73.67%	76.38%	81.79%
Profit from Operations	9.92%	24.23%	26.33%	23.62%	18.21%
Other Expenses					
Depreciation	1.70%	1.15%	1.15%	1.06%	1.05%
Amortization	0.26%	0.28%	0.29%	0.30%	0.28%
NET PROFIT	7.96%	22.80%	24.90%	22.26%	16.88%

Schedule 5

Premier Education Group, LP
Key Financial Ratios
Years Ended December 31, 2001 to 2001

	2005 RMA	2002 RMA	2005	2004	2003	2002	2001
Solvency Ratios							
Current ratio	**2.1**	**2.2**	1.09	1.07	2.86	2.40	2.27
Quick ratio	**1.7**	**1.5**	1.09	1.07	2.84	2.38	2.23
Leverage Ratios							
Debt to equity ratio	**0.6**	**0.5**	1.14	0.63	7.10	6.45	2.59
Profitability Ratios							
Return on equity	**7.60%**	**2.30%**	8.88%	10.61%	2.38%	3.37%	8.27%

Schedule 6

Premier Education Group, LP
Multi-Year Averages & Growth Rates
Years Ended December 31, 2001 to 2005

		2005		2004		2003		2002		2001
Revenue	$	47,285,201.00	$	44,317,537.00	$	35,731,949.00	$	24,569,364.00	$	13,288,217.00
Operating Profit	$	8,611,590.00	$	10,466,637.00	$	9,408,387.00	$	5,951,968.00	$	1,318,563.00
Pre Tax-Income	$	7,981,428.00	$	9,863,965.00	$	8,895,622.00	$	5,602,922.00	$	1,057,267.00
Net Income	$	7,981,428.00	$	9,863,965.00	$	8,895,622.00	$	5,602,922.00	$	1,057,267.00

Multi-Year Averages

		2005		2004		2003		2002		2001
Revenue	$	47,285,201.00	$	45,801,369.00	$	42,444,895.67	$	37,976,012.75	$	33,038,453.60
Operating Profit	$	8,611,590.00	$	9,539,113.50	$	9,495,538.00	$	8,609,645.50	$	7,151,429.00
Pre Tax-Income	$	7,981,428.00	$	8,922,696.50	$	8,913,671.67	$	8,085,984.25	$	6,680,240.80
Net Income	$	7,981,428.00	$	8,922,696.50	$	8,913,671.67	$	8,085,984.25	$	6,680,240.80

Multi-Year Growth Rates

	2004-2005	2003-2005	2002-2005	2001-2005
Average Annual				
Revenue	6.70%	15.36%	25.39%	40.26%
Operating Profit	-17.72%	-3.24%	17.20%	100.75%
Pre Tax-Income	-19.08%	-4.10%	16.86%	120.13%
Net Income	-19.08%	-4.10%	16.86%	120.13%

	2004-2005	2003-2005	2002-2005	2001-2005
Compound Annual				
Revenue	6.70%	15.04%	24.39%	37.35%
Operating Profit	-17.72%	-4.33%	13.10%	59.86%
Pre Tax-Income	-19.08%	-5.28%	12.52%	65.76%
Net Income	-19.08%	-5.28%	12.52%	65.76%

Schedule 7

Premier Education Group, LP
Projections and Discounted Cash Flow Calculation
Period from April 1 to December 31, 2002 and
Years Ended December 31, 2002 to 2006

		April 1, 2002 to December 31, 2002	2003	2004	2005	Estimated 2006
Revenues						
Earned tuition		$ 19,577,934	$ 34,560,170	$ 42,554,445	$ 43,564,836	45,743,078
Tuition refunds		(1,764,115)				
Other revenues		613,204	1,171,779	1,763,092	3,720,365	3,906,383
Total Income		18,427,023	35,731,949	44,317,537	47,285,201	49,649,461
			93.91%	24.03%	6.70%	
Education Expense						
Salaries		3,550,142	5,562,643	7,551,464	8,663,305	9,096,470
Educational suppl.ies		1,036,259	995,216	1,215,784	1,755,642	1,529,444
Selling Expense						
Salaries		914,099	1,175,642	1,773,053	1,977,167	2,076,025
Advertising		1,691,018	3,322,636	5,623,011	5,801,962	6,092,060
Administrative Expense						
Salaries		2,094,113	4,965,078	6,028,173	7,002,024	7,352,125
Office and general		2,859,533	6,692,537	7,136,909	7,975,378	8,374,147
Occupancy Expense						
Rent		1,307,339	2,395,628	3,251,384	3,780,066	3,969,069
Utilities		328,957	685,302	733,510	895,399	940,169
Maintenance and repairs		181,589	528,880	537,612	822,668	733,657
Total Operating Expenses		13,963,047	26,323,562	33,850,900	38,673,611	40,163,167
Profit from Operations		4,463,976	9,408,387	10,466,637	8,611,590	9,486,294
Other Expenses						
Depreciation		211,052	410,864	469,070	496,373	521,192
Amortization		50,732	101,901	133,602	133,789	140,478
NET PROFIT		4,202,192	8,895,622	9,863,965	7,981,428	8,824,624
Tax provision		929,063	1,966,733	2,180,824	1,764,614	1,810,242
Net income after taxes		3,273,129	6,928,889	7,683,141	6,216,814	7,014,382
Organizational						
Interest		122,905	330,852	177,342	66,103	33,052
Depreciation		211,052	410,864	469,070	496,373	521,192
Amortization		50,732	101,901	133,602	133,789	140,478
Capital expenditures		(497,622)	(710,176)	(249,237)	(526,838)	(44,629)
Change in working capital		(3,859,036)	(6,757,167)	14,189,519	(851,166)	(50,000)
Non-cash charge to partners capital		-		(21,731,192)		
General Partner management fees		67,500	30,000			
Andrew Yao alleged conversion of funds		913,217	575,085			
Organizational and curriculum costs		(15,000)	(268,000)	(25,000)	(200,000)	(132,000)
Lease Interest		10,268	18,203	11,736	8,432	5,938
Non interest bearing debt		(75,000)	(577,000)	-	-	-
Net cash flow		202,146	83,451	658,981	5,343,558	7,488,412
Discount Rate	18.30%	0.88160	0.74521	0.62993	0.53249	0.45012
Present Value of Free Cash Flows		$ 178,212	$ 62,188	$ 415,112	$ 2,845,370	$ 3,370,646
Present Value of Free Cash Flows 2003-2005		$ 6,871,528				
Terminal Value		26,610,455				
Market Value of Invested Capital		33,481,983				
Debt		3,161,948				
Market Value of Equity		$ 30,320,035				

TERMINAL VALUE

2006 Free cash flow		$ 7,488,412
Growth rate		1.050
Projected cash flow		7,862,832
WACC	18.30%	
Growth rate	5.00%	
Capitalization rate		13.30%
Capitalized Cash Flow		59,119,237
PV Factor		0.45012
Terminal Value		$ 26,610,455

2006 CAPITALIZED EARNINGS (See page 20)

2006 Free cash flow adjusted for midyear	$ 7,673,339
Capitalization rate	12.74%
Market Value of Invested Capital	60,239,813
Debt	(444,639)
100% Equity Value	$ 59,795,174

RESULTS MAY VARY DUE TO ROUNDING

APPENDIX E:
OVERVIEW OF THE U.S. ECONOMY
MARCH 31, 2002

The multitude of current articles discussing the economy's recession and it's quick turnaround reveals debate regarding whether the economy really suffered through a recession at all. Historically the rule-of-thumb is that recessions are characterized by at least two consecutive quarters of falling GDP, yet real GDP fell only in one quarter, the third quarter of 2001.[9]

In addition, economic statistics are prone to revisions, even drastic ones, as better data becomes available. It is important to note that the just-ended recession will historically be considered mild; it will also be considered a broad based one. An unusually large number of industries and regional economies experienced declining activity. Over three quarters of the close to one hundred 2-digit SIC industries and one-half of the nation's states suffered through pronounced job declines. Their breadth, not just the severity, also defines recessions.[10]

The good news is that the U.S. economy will rebound sooner rather than later, according to 35 forecasters surveyed by the Federal Reserve Bank of Philadelphia. The forecasters expect stronger growth over the next three quarters than they projected in the survey of three months ago, but some of the upward revision will come at the expense of slower growth at year's end.

The forecasters predict the economy will grow at an annual rate of 1.4%, slower than the economy's long-run potential growth rate but up significantly from their previous forecast of 0.1%. Growth is expected to accelerate to 2.6% in the second quarter and to 3.9% in the third quarter.

The forecasters were also asked to provide long-term forecasts for growth in real GDP and productivity and returns on financial assets. The table below shows that the forecasters are reducing their estimates for long-term growth in real GDP and productivity.[11]

Table 1: Long-term (10-year) Forecasts (%)

	1st Quarter 2001	1st Quarter 2002
Real GDP Growth	3.30	3.00
Productivity Growth	2.50	2.10
Stock Returns (S&P) 500	7.50	7.00
Bond Returns (10-Year)	5.50	5.50
Bill Returns (3-Month)	4.50	3.75

Source: *Survey of Professional Forecasters*

9 Zandi, Mark M. "The Recession's Over." Economy.com. March 2002. Vol 2, Number 2. Internet: http://www.dismal.com.

10 Zandi, Mark M. "The Recession's Over." Economy.com. March 2002. Vol 2, Number 2. Internet: http://www.dismal.com.

11 *Survey of Professional Forecasters*. Federal Reserve Bank of Philadelphia February 22, 2002. Internet: http://www.phil.frb.org/econ/spf/index.html

INFLATION

The Consumer Price Index rose 0.2% in February, supported by strong gains in home ownership costs, medical costs (pharmaceuticals), and a jump in the price of tobacco, which is over-weighted in the index. The rate of inflation is running 1.1% from a year ago, which suggests a minimal threat from inflation.

The low level of inflation, the ongoing strength of the dollar, and excess capacity are expected to hold inflation in check in 2002. Inflation may possibly become a threat in 2003 or early 2004 due to higher steel tariffs and an eventual tightening of labor market conditions.[12]

Downward revisions to the forecasts for CPI inflation accompany the outlook for output and unemployment. In 2002, the forecasters now predict CPI inflation will average 2.0% (on a fourth-quarter over fourth-quarter basis), down slightly from the previous forecast of 2.2%. CPI inflation will climb to 2.5% in 2003.[13]

***Table 2: Inflation Forecast* (%)**

	CPI Inflation
1999 to 2000	3.4
2000 to 2001	2.4
2001 to 2002	2.0
2002 to 2003	2.5

Source: *Survey of Professional Forecaster, Philadelphia Federal Reserves*

The survey's measure of long-term inflation stands at about the same level reported in the last quarter. Over the next 10 years inflation is expected to be (measured by the annual average rate of change in the CPI over the next 10 years) is 2.50%, down slightly from 2.55% in the last survey.[14]

EMPLOYMENT AND LABOR

A modest recovery in the overall labor market in the first quarter of 2002 was led by nonfarm payrolls increasing slightly with the majority of jobs in the service-producing employment. Within services there were gains in business services—including the key help supply category. This area includes temporary help, which acts as a leading employment indicator. Other areas with gains include health, hotels, engineering and government.[15]

[12] "U.S. Inflation." Bank One. Internet: http://www.bancone.com/commercial/research/economics/inflation/.
[13] *Survey of Professional Forecasters*. Federal Reserve Bank of Philadelphia February 22, 2002. Internet: http://www.phil.frb.org/econ/spf/index.html.
[14] *Survey of Professional Forecasters*. Federal Reserve Bank of Philadelphia February 22, 2002. Internet: http://www.phil.frb.org/econ/spf/index.html.
[15] "Employment (March) Modest Recovery, Fed on Hold." Wachovia Securities. April 5, 2002. Internet: http://www.business.firstunion.com.

Labor markets continue to be slack in most districts, as compiled by the Federal Reserve Bank of Boston, with many citing business contacts who have suspended bonuses, frozen wages, or skipped annual salary increases. However, temporary employment firms in several districts suggest employment is bottoming out and that new hires in selected occupations are said to be in short supply. One concern to many employers continues to be rising health insurance costs.[16]

Despite the revisions to growth by the consensus forecasters, the current projections of a peak at 6.0% in the middle of the year before falling gradually to 5.7% in the first quarter of 2003 are similar to the last report. The unemployment rate is expected to average 6.0% in 2002 and 5.5% in 2003.[17]

Table 3: Unemployment Rate Forecast (%)

	2000	2001	2002	2003
Unemployment	4.0	4.8	6.0	5.5

Source: *Survey of Professional Forecasters*

CONSUMER SPENDING

The Federal Reserve Board districts report retail sales during January and February were unchanged from a year earlier, but several districts noted an improvement in spending between late 2001 and early 2002. Tourism continues to be weak although most districts report improvement from the second half of 2001. Motor vehicles remain solid but down from the rapid pace set in the fourth quarter of 2001 because price promotions have ended.[18]

Despite a lack of wage and salary growth, consumer spending has risen solidly. The strength is partially due to unique factors that went consumers' way during the quarter. First, taxes were cut and refunds are running significantly ahead of their year ago pace. Second, inflation continues to be very low allowing take-home pay to go farther. Based on preliminary March reports, real consumer spending should rise at around a 4.0% annual rate during the first quarter.

The sustainability of this gain comes into question as gasoline prices have surged and the extra boost to incomes from tax refunds is dwindling. In addition, with mortgage rates back above 7.0%, refinancing activity will also likely slow.[19]

Construction and Housing Starts

Nationwide real estate markets are mixed, with commercial markets almost universally said to be weak while the residential segment remains strong. Increased office vacancy rates are reported in most of the districts. This increase has been exacerbated by active sublease markets and in some

[16] The Beige Book. "Summary." The Federal Reserve Board, Boston. March 6, 2002. Internet: http://www.federalreserve.gov.

[17] *Survey of Professional Forecasters*. Federal Reserve Bank of Philadelphia February 22, 2002. Internet: http://www.phil.frb.org/econ/spf/index.html.

[18] "Summary." The Beige Book, Federal Reserve Board. March 6, 2002. Internet: http://www.federalreserve.gov.

[19] "February personal Income & Spending." Wachovia Securities. March 29, 2002. Internet: http://www.busines.firstunion.com.

areas additional construction. Office rents have declined moderately compared with a year earlier and commercial construction has slowed in most districts.[20]

Home sales remain at historically high levels. Yet mortgage applications are tapering off slightly and higher mortgage rates will also eventually dampen the residential market. The good news for the economy is that it takes about a year to fully refurnish and remodel homes that have just been bought. Earlier home sales will continue to buoy consumer spending through 2002.
In addition, the extraordinary boost to spending provided by mortgage refinancing is beginning to play out. Mortgage refinancing has fallen considerably in the last several weeks. This will end up constraining spending growth in line with income growth: a new concept to many consumers.[21]

Sales of new homes rose 5.3% in February to a seasonally adjusted annual rate of 875,000 units. Consumers taking advantage of low mortgage rates coupled with builders taking advantage of warmer than usual weather continue to be the main drivers. Regionally, the West and South rose 10% and 6.7% in February, reversing the January drop. The Midwest inched lower at 0.6% and the Northeast dropped 10.1% in February.[22]
Looking forward, the housing market is still expected to deflate slowly as 2002 progresses. The MBA's Purchasing Index, which can be a rough indicator of new home sales, continues to decline from its cycle high in 2001.[23]

The Mortgage Bankers Association of America forecasts a decrease in total housing starts in 2002—from 1,602,000 in 2001 to 1,560,000 in 2002 (see *Table 4*).[24]

Table 4: Housing Starts Forecast (000)*

	Year to Year 2000	Year to Year 2001	Year to Year 2002
Total Starts	1,569	1,602	1,560
Single-Family	1,231	1,273	1,255
Multi-Family	338	329	305
Existing Home Sales	5,152	5,295	5,276
New Home Sales	877	907	890
Existing Home Prices (000s)	138.4	146.5	151.9
New Home Prices (000s)	166.5	171.7	176.4

*Shown as a level. Averages for the four quarters. Source: Mortgage Bankers Association of America
Existing home prices and new home prices are median prices.

[20] "Summary." The Beige Book, Federal Reserve Board. March 6, 2002. Internet: http://www.federalreserve.gov.
[21] "Housing Market." Bank One. April 9, 2002. Internet: http://www.bancone.com.
[22] "New Home Sales." Wachovia Securities. March 27, 2002, Internet: http://business.firstunion.com.
[23] "New Home Sales." First Union. March 27, 2002, Internet: http://business.firstunion.com.
[24] *MBA Economic Forecast*. Mortgage Bankers Association of America. March 11, 2002. Internet: www.mbaa.org.

MANUFACTURING AND DURABLE GOODS

Momentum continues as over the last three months orders are up 2.6% compared to a year-over-year decline. New orders for manufactured durable goods in February increased $3.2 billion. This was the third consecutive increase and is driven by gains in industrial machinery, electrical equipment, and transportation equipment. Orders are also benefiting from tax cuts and the replacement cycle from Y2K.[25]

The overall picture of manufacturing in March shows growth with a strong finish for the first quarter. Overall growth for the first quarter is stronger than predicted and capable of supporting a basis for continuing recovery. Of the 20 industries in the manufacturing sector, fifteen reported growth compared to December's report in which only three industries reported growth.

ISM's (Institute for Supply Management, formally National Association of Purchasing Management) Purchasing Managers Index (PMI) was 55.6% in March, an increase of 0.9% from the February report. The Production Index declined to 57.8% from February's 61.2% and New Orders Index rose to 65.3%. "While the growth in production slowed in February, new orders rose to a very lofty level, in fact, reaching a level last seen in October 1986. It is encouraging that the rate of decline in employment is slowing and that a number of businesses indicated that they are starting to rehire," states Norbert J. Ore, chair of the ISM's Manufacturing Business Survey Committee and group director of strategic sourcing and procurement, Georgia-Pacific Corporation.[26]

Manufacturing activity around the country is reported to be generally weak but showing signs of improvement in at least some industries. The most positive reports come form Philadelphia and Richmond, indicating "moderate" or "solid" growth in manufacturing shipments and orders in the first quarter. Most of the districts also indicate that expectations for this year all signal that a growing fraction of manufacturers expect higher production by the second half of the year. In addition, nationwide manufacturers are experiencing flat or declining costs for materials and energy. Selling prices are also mostly flat, but several districts mention modest increases in steel prices from low levels.[27]

INTEREST RATES AND FINANCIAL MARKETS

With the Fed's approach of a balanced stance on risks at its March meeting, it clearly wants to acknowledge the reaccelerating growth without stoking fears of inflation. Inflation is expected to play less of a role in economic growth than policy-making over the next several months. In fact, the future will probably cause the Fed to start outlining a policy to "normalize" interest rates, maybe as soon as the May meeting.

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[25] "Advance Durable Goods Orders-November." Wachovia Securities. April 2, 2002. Internet: http://business.firstunion.com.

[26] "March Manufacturing ISM Report on Business." Institute for Supply Management. April 1, 2002, Internet: http://www.ism.ws.

[27] "Summary." The Beige Book. The Federal Reserve Board. March 6, 2002. Internet: http://www.federalreserve.gov.

Although the first week of the new quarter brought a flurry of earnings warnings, the pace of negative announcements remains well below that of previous quarters. Corporate profit growth is likely to remain negative on a year-over-year basis in the first quarter; it does appear that economic recovery is beginning to fuel a rebound in earnings.

The first quarter showed insider buying rising strongly while insider selling falling sharply. The increase in insider purchasing of stocks stocks is encouraging because it is typically a sign of growing optimism over both the economy and corporate profits. In recent years, insider trading activity has served as a good leading indicator of stock price movements.[28]

Corporate bond yields are likely to rise less than Treasury yields this year as improving profits bolster balance sheets and credit concerns fade. Forecasters from the Federal Reserve Bank in Philadelphia expect the rate on three-month Treasury bills to rise from 1.7% in the first quarter to 2.5% by the end of the year. This is a lower level than in the previous survey. For the year as a whole they predict 3-month Treasury bills will average 2.0%, down from 2.3% in the last survey. In contrast, 10-year Treasury bonds rates will average 5.2% in 2002, an increase over the previous prediction of 4.6%.[29]

Table 5: Interest Rates and Stock Prices - Forecasts

	2000	2001	2002	2003
10-Year Treasury Bond Yield	6.03	4.90	5.20	5.50
3-Month Treasury Bill Rate	5.82	3.40	2.00	3.50

Source: *Survey of Professional Forecasters, February 22, 2002*[30]

Table 6: Interest Rates and Stock Prices - Forecasts

	Apr	Jun	Aug

[28] "S&P 500." Bank One. Internet: http://www.bancone.com.

[29] *Survey of Professional Forecasters*. Federal Reserve Bank of Philadelphia February 22, 2002. Internet: http://www.phil.frb.org/econ/spf/index.html

[30] "Survey of Professional Forecasters." Federal Reserve Bank of Philadelphia. February 22, 2002. Internet: http://www.phil.frb.org.

	2002	2002	2002
Prime Interest Rate	4.75	4.75	5.00
30-Year Treasury Bond Yield	5.58	5.45	4.75
3-Month Treasury Bill Rate	2.05	2.48	1.80
Stock Prices (S&P)	1,125	1,297	1,299

Source: *The Financial Forecast Center, April 1, 2002* [31]

SUMMARY AND OUTLOOK

The risks to the U.S. economy remain on the downside. These risks include a tentative stock market, which continues to be confused regarding the depths of the accounting irregularities in corporate America. The fragile U.S. recovery could also be threatened by the recessionary global economy. Economies from Brazil, Canada, Germany, Japan, Mexico and Singapore are all in recession, which could affect the U.S. significantly if something else goes very badly.

The Federal Reserve is expected to maintain a very accommodative monetary policy throughout the upcoming year, and fiscal stimulus may also be ultimately needed to move the economy from what is expected to be disappointing growth early in this recovery before it reaches its potential growth.[32]

Growth in the 4th quarter will slow to 3.2%, a downward revision from 4.0% in the last survey. In 2002, forecasters project real GDP growth of 1.4% and 3.5% in 2003.[33]

Table 7: Growth Rate (%)

	Real GDP
2002	1.4
2003	3.5

Source: *Survey of Professional Forecasters*

[31] The Financial Forecast Center. April 1, 2002, Internet: http://www.forecasts.org.

[32] Zandi, Mark M. "The Recession's Over." Economy.com. March 2002. Vol 2, Number 2. Internet: http://www.dismal.com.

[33] *Survey of Professional Forecasters.* Federal Reserve Bank of Philadelphia February 22, 2002. Internet: http://www.phil.frb.org/econ/spf/index.html.

APPENDIX F:
OVERVIEW OF THE U.S. ECONOMY
DECEMBER 31, 2006

Most Federal Reserve Districts reported continued moderate growth in the fourth quarter of 2006, according to the latest *Beige Book*. However, New York and Richmond observed that growth accelerated, while Dallas indicates the pace of activity continued to decelerate from high levels. Atlanta described its economic activity as mixed. With the exception of continuing softness in the auto and housing-related sectors, most Districts reported that consumer spending increased during October and early November, and retailers were cautiously optimistic for holiday season sales.[34]

Growth in other service-producing industries remained generally solid and manufacturing activity was positive overall. Single-family home sales in general continued to decline, and there were some reports of lower home prices. Single-family construction continued to weaken in most Districts, though housing demand continued to be strong in a few specific markets and nonresidential activity generally improved. Mortgage lending slowed in many Districts, but reports on other lending were mixed. Labor markets continued to be tight in several Districts, especially for high-skilled workers. Wage growth was generally moderate, and prices for construction materials and energy products moderated.[35]

According to the 51 forecasters surveyed by the Federal Reserve Bank of Philadelphia, the projected rate of growth in U.S. output over the next few quarters looks slower now than it did in third quarter 2006. The largest downward revisions to growth occur in the next two quarters, when the forecasters expect real GDP to grow at an annual rate of 2.5 percent in the current quarter, down from their previous estimate of 2.9 percent, and 2.7 percent in the first quarter of 2007, down from 2.9 percent. On an annual-average over annual-average basis, real GDP will grow 3.3 percent in 2006 and 2.6 percent in 2007, down from previous forecasts of 3.4 percent and 2.8 percent, respectively (see *Table 1*).[36]

Table 1: Real GDP (%)

	Previous	New
2006 Q4	2.9	2.5
2007 Q1	2.9	2.7
2006 Annual Average	3.4	3.3
2007 Annual Average	2.8	2.6

Source: Survey of Professional Forecasters, November 13, 2006

[34] "Summary." *The Beige Book*. Federal Reserve Board. November 29, 2006. Internet: http://www.federalreserve.gov/FOMC/BeigeBook/2006/20061129/default.htm.
[35] *Ibid.*
[36] *Survey of Professional Forecasters*. Federal Reserve Bank of Philadelphia. November 13, 2006. Internet: http://www.phil.frb.org/files/spf/survq406.html.

INFLATION

The short-run inflation outlook looks better in fourth quarter 2006 than it did in the third quarter, measured by either the rate of change in the consumer price index or the price index for GDP. The forecasters expect CPI inflation to average 2.4 percent in 2006 (fourth-quarter over fourth-quarter), down almost a percentage point from their previous estimate of 3.3 percent, and 2.6 percent in 2007, unchanged from the estimate of three months ago (see *Table 2*).[37]

***Table 2: Inflation Forecast* (%)**

	CPI Inflation
2004	3.4
2005	3.9
2006	2.4
2007	2.6
2008	2.5

Source: Survey of Professional Forecasters, November 13, 2006

The forecasters project long-term inflation over the next five years of 2.6 percent and 2.5 percent over the following five-year period. These estimates are nearly unchanged from those of the previous survey. On average, over the next 10 years, CPI inflation is expected to be 2.5 percent.[38]

EMPLOYMENT AND LABOR

The unemployment rate in November 2006 was 4.5 percent, essentially unchanged from October, according to the Bureau of Labor Statistics (BLS) of the U.S. Department of Labor. The unemployment rate has decreased from 5.0 percent recorded a year ago. Nonfarm payroll employment increased by 132,000 in November. The job gains continued in several service-providing industries, including professional and business services, food services, and health care. November's employment declined in construction and manufacturing.[39]

The *Beige Book* reports labor markets have remained tight across the country, especially for high-skilled occupations. Skills noted to be in short supply included engineers, oil field workers, accountants, welders, sales people, and truck drivers. Wage growth remained generally moderate, but Boston, New York, and San Francisco reported faster wage growth for some specialized professions including health care, finance, construction, and technical jobs. Employers in the Philadelphia District indicated that wages have been rising more rapidly in the past few months than earlier in the year, while Chicago employers reported the pace of wage increases was steady.[40]

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[37] *Ibid.*
[38] *Ibid.*
[39] "The Employment Situation: November 2006." Bureau of Labor Statistics. United States Department of Labor. December 8, 2006. Internet: http://www.bls.gov.
[40] "Labor Markets and Prices." *The Beige Book.* Federal Reserve Board. November 29, 2006. Internet: http://www.federalreserve.gov/FOMC/BeigeBook/2006/20061129/default.htm.

The Federal Reserve of Philadelphia survey forecasts steady performance in the labor market, despite the somewhat weaker outlook for growth. Forecasters project the unemployment rate will average 4.7 percent for the entire year of 2006, unchanged from the previous estimate, and 4.8 percent in 2007, down marginally from the previous estimate of 4.9 percent (see *Table 3*). Monthly job gains of 155,000 are projected in 2006, up from the previous estimates of 154,000, but for 2007, monthly job gains of 119,000 are forecast, down from the previous estimates of 126,000.[41]

Table 3: Unemployment Rate Forecast (%)

	2004	2005	2006	2007
Unemployment	5.5	5.1	4.7	4.8

Source: *Survey of Professional Forecasters*, November 13, 2006

CONSUMER SPENDING

The Conference Board Consumer Confidence Index, which is based on a representative sample of 5,000 U.S. households, was virtually unchanged in November and then improved in December. The Index now stands at 109.0, up from 105.3 in November.

It isn't clear, however, that the improvement is meaningful, says Lynn Franco, Director of The Conference Board Consumer Research Center. According to Franco, "Despite the latest improvement in the Index, there is little to suggest that the pace of economic activity in the final quarter of 2006 is anything but moderately better than its uninspiring performance earlier this year. Given the see-saw pattern in recent months, it is too soon to tell if this boost in confidence is a genuine signal that better times are ahead."[42]

According to the *Beige Book*, although overall consumer spending increased in most Districts, there were some regional variations in the rate of increase. Kansas City and Richmond reported solid increases, while modest improvements in retail spending were noted in Atlanta, Chicago, Minneapolis, New York, and St Louis. Sales softened in the Boston District and were below expectations in the Dallas District.

Strong-selling products also varied by region, but most Districts reported that sales of home-related items remained weak. Several Districts noted a cautiously optimistic outlook for the holiday season. Most Districts reported continued softness in vehicle sales, led by weaker sales for the Big Three U.S. automakers. Slow or declining sales and high vehicle inventories were

[41] *Survey of Professional Forecasters*. Federal Reserve Bank of Philadelphia. May 15, 2006. Internet: http://www.phil.frb.org/files/spf/survq406.html.

[42] "The Conference Board Consumer Confidence Index Improves in December." Consumer Confidence Board. December 28, 2006. Internet: http://www.conference-board.org.

reported by several Districts. The only account of improved vehicle sales came from St. Louis. Chicago described auto sales as steady.[43]

CONSTRUCTION AND HOUSING STARTS

Residential real estate markets – especially the single-family segment - continue to cool across much of the country, with most Districts of the Federal Reserve reporting declining sales and rising home inventories, according to the *Beige Book*. Five Districts reported the use of non-price sales incentives and there were scattered reports of price reductions. Most Districts also reported declines in construction, and several expect the weak conditions to persist over the next several months. New York and Dallas noted improved demand for rental housing, while Dallas reported condominium construction remained robust. In Atlanta, some markets reported rising condo vacancy rates.[44]

The National Association of Home Builders (NAHB) reports that unseasonably warm November weather helped boost housing starts 6.7 percent to a seasonally adjusted annual rate of 1.588 million units for the month. However, year-over-year, total housing starts in November were down 25.5 percent.

In an effort to control their inventories, builders reduced the pace of permit issuance another 3.0 percent in November to an annual rate of 1.506 million units, a level 31.3 percent below November 2005 levels. Single-family permits were down 3.1 percent on a national basis to a pace of 1.144 million units for the month, a level 33.3 percent below a year earlier. Multi-family permits were down 2.7 percent for November, and 23.8 percent below November 2005.

According to NAHB's Chief Economist David Seiders, "The pattern of building permits points toward some reduction in housing starts in coming months. NAHB's forecast shows a bottoming in starts in the first quarter of next year, followed by a recovery process that will raise housing production back up toward a sustainable trend performance in 2008."[45]

Another indication of the cooling trend is the continuing downward trend of mortgage applications for home purchases. The Mortgage Bankers Association (MBA) reports its market composite index for the week ending December 22 declined by 14.2 percent on a seasonally adjusted basis compared with the one-week earlier. On an unadjusted basis, the index decreased 15 percent compared with the previous week and was up 16.6 percent compared with the same week a year earlier.[46]

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[43] "Consumer Spending." *The Beige Book*. Federal Reserve Board. November 29, 2006. Internet: http://www.federalreserve.gov/FOMC/BeigeBook/2006/20061129/default.htm.
[44] "Real Estate and Construction." *The Beige Book*. Federal Reserve Board. November 29, 2006. Internet: http://www.federalreserve.gov/FOMC/BeigeBook/2006/20061129/default.htm.
[45] "Housing Starts Up In November, Permits Continue Moderate Decline." National Association of Home Builders. Press Release. December 19, 2006. Internet: http://www.nahb.org/news_details.aspx?newsID=3798.
[46] "Mortgage Applications Decrease in Week before Christmas." Press Release. Mortgage Bankers Association. December 27, 2006. Internet: http://www.mortgagebankers.org/NewsandMedia/PressCenter/47161.htm.

In contrast, nonresidential markets in most Districts have improved since the last report, according to the Federal Reserve. Strengthening demand for office space was reported in the Boston, Dallas, Kansas City, Minneapolis, New York, and Philadelphia regions. However, some slowing was noted in the Chicago District, and Atlanta noted that the overall level of nonresidential construction remained modest. In the San Francisco District, commercial and public project activity continued to expand, although the pace of growth was slower than earlier in the year.[47]

MANUFACTURING AND DURABLE GOODS

Economic activity in the manufacturing sector expanded in December following a one-month decline, while the overall economy grew for the 62nd consecutive month, according to the nation's supply executives in the latest *Manufacturing ISM* (Institute for Supply Management) *Report on Business*. "Manufacturing proved resilient in December, as the [Purchasing Managers Index] returned to growth registering 51.4 percent after a decline (under 50 percent) in November," according to Norbert J. Ore, C.P.M., chair of the ISM Manufacturing Business Survey Committee. A reading above 50 percent indicates that the manufacturing economy is generally expanding; below 50 percent indicates that it is generally contracting. [48]

Other ISM indexes were favorable also. The Production Index rose 3.3 percentage points from 48.5 percent in November to 51.8 percent in December. The New Orders Index grew 3.4 percent in December to a reading of 52.1 percent, up from 48.7 percent registered in November. The Employment Index showed a negligible change for the second consecutive month, and the Prices Index is trending downward, relieving some of the inflationary pressure that has troubled manufacturing since mid-2003.[49]

Of the 20 industries in the manufacturing sector, nine reported growth in December: Apparel; Leather and Allied Products; Printing and Related Support Activities; Plastics and Rubber Products; Miscellaneous; Petroleum and Coal Products; Computer and Electronic Products; Primary Metals; Chemical Products; and Food, Beverage, and Tobacco Products.[50]

The Fed's *Beige Book* reports that manufacturing activity was generally positive in most Districts, although most also reported substantial declines in orders for homebuilding materials and related equipment. New York said manufacturers noted brisk growth in activity, and four other Districts reported that production trends in high-tech industries were positive. Some softness in auto and auto-related production was noted by five Districts. However, Chicago

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[47] "Real Estate and Construction." *The Beige Book*. Federal Reserve Board. November 29, 2006. Internet: http://www.federalreserve.gov/FOMC/BeigeBook/2006/20061129/default.htm.
[48] "December 2006 Manufacturing ISM *Report on Business*." Institute for Supply Management. January 3, 2007. Internet: http://www.ism.ws.
[49] *Ibid.*
[50] *Ibid.*

reported modest expansion in activity, with manufacturers of machine tools and equipment reporting strong demand outside of the motor vehicle industry.[51]

Interest Rates and the Stock Market

The Federal Reserve is expected to maintain the federal funds rate at 5.25 percent for at least one more quarter, though most analysts and traders project the rate will begin to decline again by the middle of next year. The degree of decline anticipated for 2007 varies unusually widely, however. One economist expects the rate to be slashed to 3.75 percent by the end of 2007. The majority, however, forecast a year-ending rate of 4.75 percent or 5.0 percent.

November's National Association for Business Economics (NABE) survey of 50 forecasters suggests cautious optimism for economic growth in 2007. "Despite the hindrance of the housing correction, the economy is expected to continue gaining ground in 2007. Our panel suggests, though, that we'll need to pay close attention to energy prices, home sales, and inflation, which could threaten the expansion's durability," according to Carl Tannenbaum, NABE president. When asked what factor might cause the Fed to depart from its current pause, some panel members cited easing of inflation, but more expect further economic slowing to provide the necessary trigger.[52]

Members of the Bond Market Association's (BMA) Economic Advisory Committee expect the Fed to leave the Fed funds rate unchanged in December and again in March 2007, with a cut in rates of 25 basis points expected later in 2007. *Table 4* shows the BMA's forecast for key interest rates.[53]

Table: 4: Interest Rates (monthly average %)

	Dec 06	Mar 07	June 07	Sept 07	Dec 07
Fed Funds	5.25	5.25	5.20	5.00	5.00
2 Year Treasury Note	4.68	4.65	4.73	4.70	4.65
10 Year Treasury Note	4.60	4.60	4.70	4.80	4.80
30 Year Fixed-Rate Home Mortgages	6.20	6.18	6.23	6.35	6.50
Municipals (Bond Buyer GO Index)	4.25	4.33	4.40	5.60	4.50
Moody's Corporate Bond Index (A Rated)	5.50	5.50	5.60	5.80	6.00

Source: The Bond Market Association

Trading on Wall Street has reflected the heightened volatility in financial markets and heightened uncertainty about Fed policy under its new chairman, Ben S. Bernanke. For the week

[51] "Manufacturing." *The Beige Book.* Federal Reserve Board. November 29, 2006. Internet: http://www.federalreserve.gov/FOMC/BeigeBook/2006/20061129/default.htm.

[52] "NABE Outook: Economy Advancing, but Housing in Retreat." Press Release. National Association for Business Economics. November 20, 2006. Internet: www.nabe.com.

[53] "Economic Outlook: Economic Expansion Maintained Through 2007 Despite Housing Correction; Lower Inflation Expected." The Bond Market Association. December 11, 2006. Internet: http://www.bondmarkets.com/story.asp?id=2716.

prior to the meeting, trading was characterized as "mostly sideways," with the Dow Jones industrial average up just 2.5 percent for the year as of June 23, while the NASDAQ Composite and Standard & Poor's 500-stock index were down 3.8 percent and 0.3 percent, respectively, for the year.[54]

Although stocks slipped slightly at the end of December, in general fourth quarter stock trading was "upbeat," according to analysts. "The market is supposed to do well in the fourth quarter and that's exactly what it did," said Chris Johnson, chief executive officer at Johnson Research Group. Johnson said the seasonal trend of a strong fourth quarter is typically the best of the year for stocks. The year-long 2006 stock market advance was the best since 2003, when the major gauges surged in a broad rally following a three-year bear market. While stock gains in 2006 were smaller than 2003, they were nonetheless far better than what many prognosticators were expecting.[55]

January could bring some weakness on Wall Street, analysts say, as investors that have held off taking profits on 2006 gains for tax reasons opt to sell some winners. In addition, the arrival of the new Congress in late January and the start of fourth-quarter earnings pre-announcements could all set markets up for a pullback. Standard & Poor's currently expects fourth-quarter earnings to have grown 9.4 percent, marking the first quarter of earnings growth of less than 10 percent since the first quarter of 2002. Yet longer term, the outlook for 2007 is more positive.[56]

SUMMARY AND OUTLOOK

The 51 forecasters surveyed by the Federal Reserve Bank of Philadelphia forecast economic growth will equal 2.5 percent (annual rate) in the fourth quarter, followed by 2.7 percent growth percent in the first quarter of 2007. For the year 2006, the forecasters estimate an annual growth rate of 3.3 percent and 2.6 percent in 2007.[57]

Analysts at Wachovia's Economics Group forecast the U.S. economy will grow at a "sub-trend" pace in 2007, following three years of strong growth. Consumer spending and residential construction, which were the major drivers in U.S. real GDP growth over the past few years, are starting to slow, if not reverse. However, the Wachovia analysts project that the downturn in the housing market will not pull other sectors down with it.[58]

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[54] McDonald, Ian. "Markets Slip During Quiet Summer Session." *The Wall Street Journal.* June 24, 2006, p. B1.
[55] Twin, Alexandra. "Mild Day, Strong Year for Stocks in '06." CNNMoney.com. December 29, 2006. Internet: http://money.cnn.com/2006/12/29/markets/markets_0405/index.htm.
[56] *Ibid.*
[57] *Survey of Professional Forecasters*. Federal Reserve Bank of Philadelphia. November 13, 2006. Internet: http://www.phil.frb.org/files/spf/survq406.html.
[58] "2007 Annual Outlook." Wachovia. December 14, 2006. Internet: http://www.wachovia.com/corp_inst/page/0,,13_54_1067,00.html.